Issue Papers

2004 Legislative Session

Presentation to the

Maryland General Assembly

Department of Legislative Services
Office of Policy Analysis
Annapolis, Maryland

December 2003

For further information concerning this document contact:

Library and Information Services
Office of Policy Analysis
Department of Legislative Services
90 State Circle
Annapolis, Maryland 21401

Baltimore Area: 410-946-5400 ● Washington Area: 301-970-5400
Other Areas: 1-800-492-7122, Extension 5400
TDD: 410-946-5401 ● 301-970-5401
Maryland Relay Service: 1-800-735-2258
E-mail: libr@mlis.state.md.us
Home Page: http://mlis.state.md.us

December 30, 2003

Members of the General Assembly:

Prior to each session, staff of the Department of Legislative Services, Office of Policy Analysis, prepare an information report on issues. This document is a compilation of the issue papers arranged by major topic. The information reflects the status of the items as of December 1, 2003.

Following each paper is an identification of the staff who worked on a particular topic. If you should need additional information, please do not hesitate to contact the appropriate staff person.

We trust this information will be of assistance to members of the General Assembly.

Sincerely,

Karl S. Aro
Executive Director

KSA/lc

Contents

Operating Budget

Economic and Revenue Outlook

The good news is that as the State's economy recovers from the 2001 recession, State revenues are forecasted to increase by 3.8 percent in fiscal 2004 and 4.6 percent in fiscal 2005 after adjusting for transfers and law changes. The bad news is that because the recovery is happening later than expected, estimated fiscal 2004 State revenues are lower by about $65 million than previously forecasted.

Economic Outlook

2001 marked the end of the longest economic expansion in U.S. history. Officially, the recession began in March 2001 and ended in November 2001. Employment and personal income growth in Maryland slowed significantly. After rising by more than 2.5 percent for four straight years, employment in Maryland grew by just 0.7 percent in 2001 and 0.2 percent in 2002. Personal income growth similarly slowed from over 8 percent in 2000 to around 5 percent in 2001 and 3.8 percent in 2002. Still the recession in Maryland was much less severe than for the nation as a whole. While the U.S. economy has lost 2 percent of its job base, around 2.7 million jobs, Maryland never lost jobs on an annual basis. For several months in late 2001, the Maryland economy lost jobs on a year-over-year basis. However, in both 2001 and 2002 Maryland added a modest number of jobs (17,000 in 2001 and 5,400 in 2002). This is in striking contrast to the last recession in the early 1990s when Maryland economy lost 5 percent of its job base and lost jobs in two consecutive years (1991 and 1992).

The current recovery is unique in that the U.S. economy has continued to lose jobs twenty-two months after the recession officially ended in November 2001. Worse than the jobless recovery of the early 1990s, the U.S. economy is experiencing what many are calling a "job-loss" recovery. Since November 2001, the U.S. economy has lost a little over one million jobs through September 2003. Again the Maryland economy has fared better. In September 2003, Maryland had about 800 more jobs than it had in November 2001.

Despite the relatively good economic news for Maryland, the economic outlook today is slightly weaker than the forecast from December 2002 that was the basis of the Board of Revenue Estimates revenue projections (**Exhibit 1**). This is due largely to weakness in the Maryland economy in early 2003. Maryland experienced three consecutive months of year-over-year job loss at the beginning of the year. This results in a downward revision for total employment and personal income growth for all of calendar 2003. Similarly, the outlook for 2004 is slightly weaker as the economy gradually steps up to something approaching long-term trend growth in 2005 and 2006. Also helping to keep income growth relatively low in 2003 and 2004 are the very low interest rates, which are depressing interest earnings. While not a huge share of total personal income, interest earnings are large enough to affect the growth rate at the margin.

Exhibit 1
Economic Outlook
Forecasted Year-over-Year Percentage Change

Calendar Year	Employment Dec. 2002	Employment Sept. 2003	Personal Income Dec. 2002	Personal Income Sept. 2003
2000	2.6%	2.6%	7.8%	8.1%
2001	0.8%	0.7%	4.9%	5.0%
2002	(0.6%)	0.2%	4.1%	3.8%
2003E	1.0%	0.7%	4.4%	4.0%
2004E	1.6%	1.4%	5.3%	4.5%
2005E	1.9%	1.9%	5.3%	4.9%
2006E	1.5%	1.9%	5.0%	5.2%

Source: December 2002 is from the Board of Revenue Estimates. September 2003 is from the Department of Legislative Services.

Revenue Outlook

The weak economic outlook has impacted the revenue outlook for the State. Fiscal 2003 ended $34 million above the estimate and fell 1.0 percent from fiscal 2002. However, there were a number of one-time or temporary items in both years. Adjusting for those items, ongoing general fund revenues were below the estimate by $11 million and down from 2002 by 0.4 percent. The largest revenue source, the personal income tax, exceeded the estimate in 2003 but was down 1.4 percent from 2002. This is the second year in a row that personal income tax revenue fell although the decline this year was much less than the 7.1 percent drop in fiscal 2002.

The Department of Legislative Services (DLS) estimates that in fiscal 2004, total general fund revenues will be about $65 million less than currently expected and will grow about 6.5 percent over fiscal 2003 (**Exhibit 2**). There are a number of temporary items in both years. Abstracting from these impacts, DLS estimates that *ongoing* general fund revenues will be about $91 million less than currently anticipated and will grow by 6.7 percent over fiscal 2003. There are a number of statutory changes that impact the growth rate vis-à-vis 2003. These include various permanent and temporary provisions of the Budget Reconciliation and Financing Acts of 2002 and 2003. In addition, general fund revenues in fiscal 2004 include about $115 million that were special fund revenues in fiscal 2003. Adjusting for all of these changes results in underlying *ongoing* general fund revenue growth of 3.8 percent in fiscal 2004 and 4.6 percent in fiscal 2005.

Exhibit 2
Maryland General Fund Revenue Forecast
($ in Millons)

	Fiscal 2004				Fiscal 2005	
	Current Official Estimate	**DLS Sept. 2003**	**$ Diff.**	**% Change 2003–2004**	**DLS Sept. 2003**	**% Change 2004–2005**
Personal Income Tax	$5,100	$5,014	($85)	6.0%	$5,258	4.9%
Sales & Use Tax	2,829	2,819	(11)	4.5%	2,931	4.0%
Lottery	451	428	(23)	1.1%	446	4.3%
Other	1,703	1,757	55	12.6%	1,681	(4.3%)
Total	**$10,083**	**$10,018**	**($65)**	**6.5%**	**$10,316**	**3.0%**

Source: Board of Revenue Estimates; Department of Legislative Services

Operating Budget

Budget Outlook

Following the unprecedented economic growth of the 1990s, the nation entered a recession in the spring of 2001 that curtailed State revenues. The reaction to two years of revenue declines has included budget cuts, limited revenue enhancements, and a large reliance on one-time funding transfers. The enactment of landmark education legislation at the 2002 session, a new administration opposed to major tax increases, and ongoing spending commitments have combined for a decidedly precarious fiscal environment. The 2004 session will again be overshadowed by the budget, as options to revisit education spending, the potential for gambling revenue, and other revenue and spending alternatives are considered.

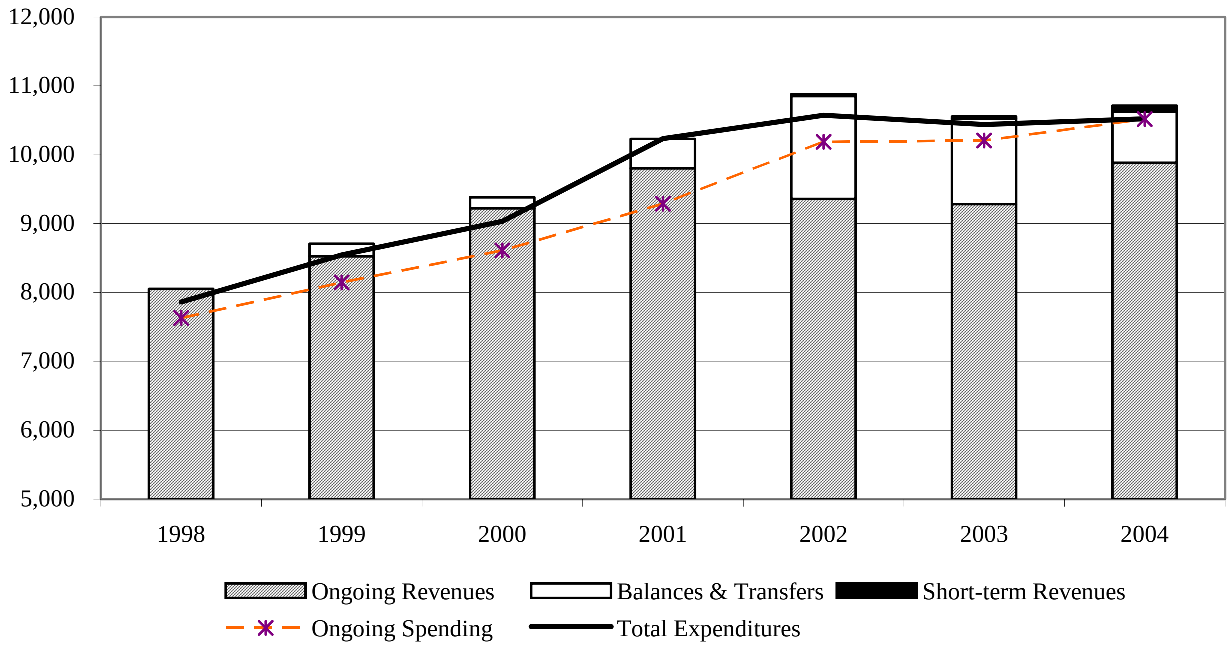
Anatomy of a Fiscal Crisis

In March 2001, the nation experienced the first major economic downturn in a decade, following a period of unprecedented growth during the mid to late 1990s. Like most states, Maryland managed the unexpectedly higher revenue attainments by adopting measures to balance tax relief and spending. Specific actions included the phased implementation of a 10 percent income tax reduction, increased funds placed in reserve, one-time spending for pay-as-you go (PAYGO) capital projects, and spending growth within the recommendations of the Spending Affordability Committee. At the same time, the states received a large unexpected infusion of funding from a settlement with tobacco companies relating to the state health costs from cigarettes.

The picture began to change by the fall of 2000, influenced by the contested presidential election and the overvaluation of the stock value of Internet based companies. Revenues began to weaken first in states with a strong reliance on the sales tax (e.g., Tennessee and Florida) in the spring of 2001. Maryland's revenue picture began to cloud in the summer and fall, exacerbated in part by the September 11 terrorist attack. **Exhibit 1** illustrates the strong position that Maryland was in from fiscal 1998 through 2001. Throughout the period the budget was balanced in a business sense (i.e., comparing ongoing revenues against ongoing spending), and surplus balances were generally applied to one-time PAYGO spending.

Fiscal 2002 and 2003 were characterized by declines in ongoing general fund revenues, which placed the budget far out of balance in a business sense. However, the State was able to maintain spending without a major restructuring of the budget through a variety of one-time measures.

Exhibit 1
General Fund Revenue and Expenditure Trends
($ in Millions)



Source: Department of Legislative Services

Over $2.7 billion in one-time transfers were effected to help maintain fiscal equilibrium during fiscal 2002 and 2003. Most of this revenue came from surplus general fund balances, Rainy Day Account balances above the statutorily required 5 percent, transfers from the Transportation Trust Fund, a limited diversion of a portion of transfer tax revenue to the general fund, one-time federal aid, and a host of transfers from a variety of fund balances. Although revenue growth is expected to improve in fiscal 2004 as the economy begins to rebound, the structural imbalance persists in part due to spending pressure.

Spending Pressures Make a Bad Situation Worse

In the private sector, revenue declines result in spending reductions, given the nexus between profit and viability. Government's ability to react and restructure is made more difficult partly because of statutory mandates and the consensus building nature of the political system. One-half of the State budget consists of aid to local subdivisions and entitlements, much of which has a statutory basis. Much of the remaining budget, consisting of State agency spending, provides aid to higher education, health and mental health services, and prisons – a large portion of which supports personnel-related expenses for the nearly 80,000 complement of regular positions. Despite reductions in the number of positions and agency cost containment, spending pressures continue to pose problems related to:

- **Landmark education spending –** Legislation enacted in 2002 restructured Maryland's primary and secondary education financing system and phases in an additional $1.3 billion in enhanced State aid through fiscal 2008. Questions surround the legality of a provision to affirm the affordability of the full program via a joint resolution during the 2004 session. A 34-cent cigarette tax increase funds a small portion of this commitment.

- **Medicaid and mental health spending –** Health spending has been driven by continued Medicaid caseload growth, medical inflation, and chronic underfunding of mental health services. Medicaid spending nationwide is projected to continue to consume a larger portion of state budgets.

- **Personnel and operations –** Cost increases related to health insurance, salary increments, and other ongoing costs, as well as new positions related to caseloads, new facilities, and legislation can be expected to also require larger allocations of resources. Capital spending has been recommended to increase to $650 million for fiscal 2005 by the Capital Debt Affordability Committee.

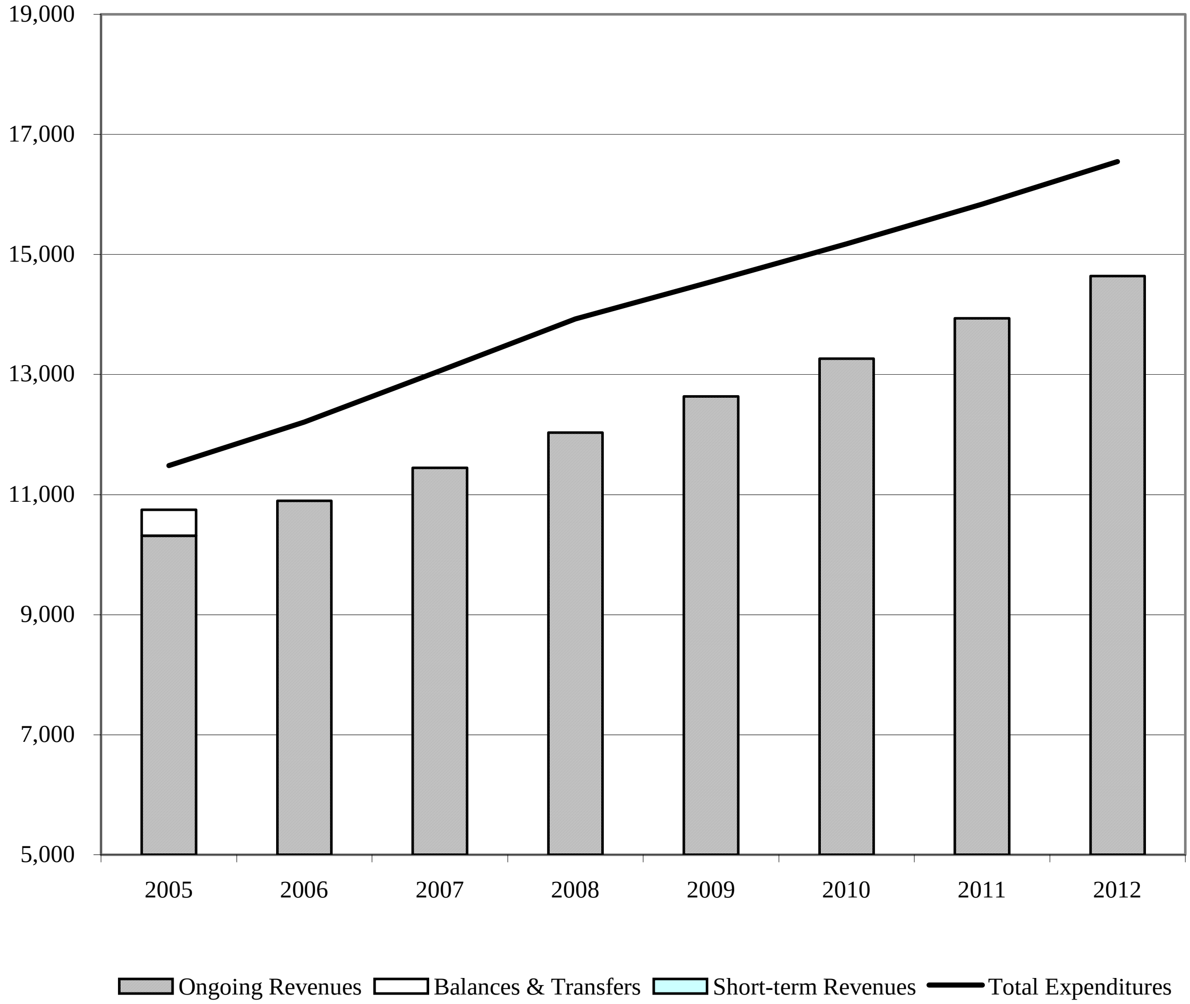
Outlook for Fiscal 2005 and Beyond

Exhibit 2 portrays the Department of Legislative Services' (DLS) out-year revenue and expenditure outlook. Based in part on the spending pressures outlined above, combined with revenue growth from a lower base, DLS projects that the current revenue stream is insufficient to meet projected spending needs based on current law and service levels.

Although the budget is projected to be balanced on a cash basis in fiscal 2004, the reliance on one-time solutions coupled with the underlying spending growth simply means that the problem will continue to return until it is resolved. Thus, the problem in fiscal 2005 will require at least $738 million to have a balanced budget or roughly $1.0 billion to attain balance in a business sense. Left unresolved, the problem is projected to grow to $1.9 billion by fiscal 2008, although clearly with Maryland's requirement for a balanced budget at the introduction and completion of the legislative session such deficits will not materialize in practice. The full detail on the budget outlook is provided in **Appendix 1**.

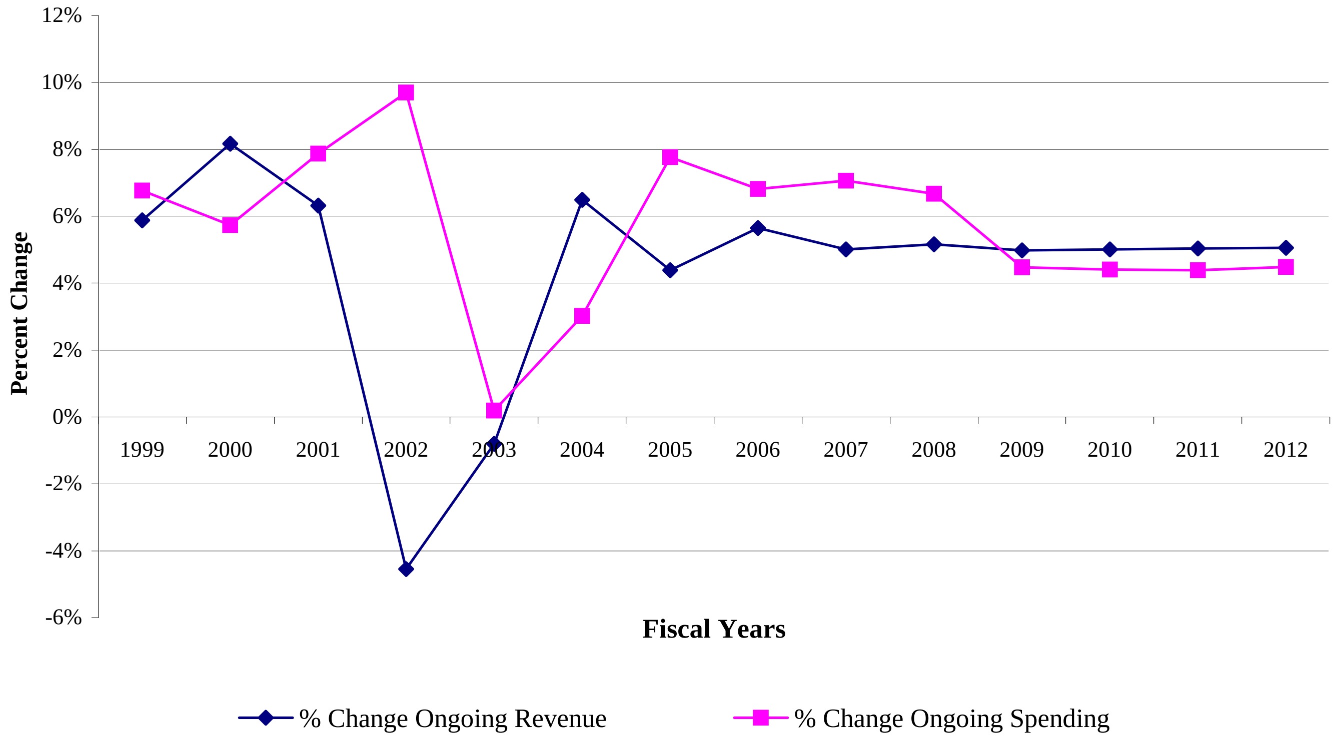
The news, however, is not all bad. Although the long-term outlook reflects a structural deficit, ongoing revenue growth is forecast to again outpace ongoing spending beginning in fiscal 2009. The implication is that once the large funding commitments related to the implementation of the education spending enhancement are completed, then structural balance will be restored. **Exhibit 3** illustrates the percentage change in ongoing spending and revenues for the 1999 through 2012 forecast period.

Exhibit 2
DLS Fiscal 2005 – 2012 Budget Outlook
($ in Millions)



Source: Department of Legislative Services

Exhibit 3
Percentage Change in Ongoing Revenue and Expenditures
Fiscal 1999 – 2012



Source: Department of Legislative Services

So Where Do We Go from Here?

Action to restore balance in the State budget will, by reason of its sheer magnitude, require a multi-year and multi-pronged approach. This would be expected to include some combination of revenue enhancements, use of one-time transfers, and spending reductions. The list of options includes:

- **Use of the Rainy Day Account** – Projected to end fiscal 2004 with a balance of $498.5 million (equal to 5 percent of general fund revenues), funds could be used to mitigate larger revenue and reduction actions for a year. Repayment would be required in subsequent years.

- **Spending reductions –** Given the magnitude of the problem and the growth areas in the budget (local aid and Medicaid) the viability of balancing the budget exclusively through actions to State agencies becomes more challenging. The affordability of the enhanced program of primary and secondary education, and questions surrounding the legality of the 2004 joint resolution, suggest that revisiting the magnitude, phasing, and structure should be considered during the 2004 session. It would also be prudent to examine the level of services and number of personnel in State agencies and entitlement programs. Scaling back Medicaid spending, mental health services, and other services could be considered.

- **Revenue enhancements –** Despite the failure of 2003 session legislation to permit slot machines at horse racing facilities in the State, an interim study of gambling has been ongoing and may lead to recommendations to implement some form of slot or casino style entertainment. Legislation to close corporate tax loopholes was vetoed following the 2003 session but could be overridden or reintroduced during the 2004 session. The Administration has not expressed support for increases in the sales or income taxes; however, transportation revenue enhancements are being contemplated. Some portion of any increases could be shared with the general fund. Finally, short-term revenue measures, such as the three-year diversion of a portion of the transfer tax to the general fund, could be made permanent.

In conclusion, the State continues to face a daunting task of balancing a budget shortfall approaching a billion dollars while trying to enhance education spending and meet other spending commitments. For practical purposes, actions during the 2004 session will of necessity require a combination of revenue enhancements, spending reductions, and some degree of one-time transfers.

For further information contact: David B. Juppe Phone: (410) 946/(301) 970-5530

General Fund Projections

($ in Millions)

	Leg. Approp. FY 2004	Baseline FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	Annual Growth Rate FY 04-05	Avg. Grov FY
Revenues – October 2003 DLS Estimate											
Individual Income	$4,962	$5,258	$5,588	$5,923	$6,293	$6,676	$7,083	$7,515	$7,973	6.0%	
Sales and Use	2,808	2,931	3,073	3,238	3,403	3,576	3,758	3,950	4,151	4.4%	
Lottery	428	446	455	466	477	490	504	518	533	4.3%	
Other	1,685	1,681	1,781	1,818	1,861	1,890	1,920	1,949	1,980	-0.2%	
Subtotal	**$9,883**	**$10,316**	**$10,898**	**$11,444**	**$12,034**	**$12,633**	**$13,265**	**$13,933**	**$14,637**	**4.4%**	
Adjustments											
Balance	$123	$188	$0	$0	$0	$0	$0	$0	$0		
One-time Federal Aid	244	0	0	0	0	0	0	0	0		
Short-term Revenues	88										
Rainy Day Fund Transfer	0	113	0	0	0	0	0	0	0		
BRFA of 2003 and Other Fund Transfers	376	128	0	0	0	0	0	0	0		
Total Revenues	**$10,713**	**$10,745**	**$10,898**	**$11,444**	**$12,034**	**$12,633**	**$13,265**	**$13,933**	**$14,637**	**0.3%**	
Expenditures											
Debt Service	$0	$0	$8	$74	$73	$89	$94	$105	$107	n.a.	
Local Aid – Education\Libraries (includes deficiencies)	3,365	3,748	4,099	4,455	4,875	5,003	5,130	5,244	5,373	11.4%	
Local Aid – Other	441	453	470	486	504	522	540	557	578	2.8%	
Entitlements (includes deficiencies)	2,077.4	2,251	2,420	2,606	2,804	3,020	3,251	3,504	3,775	8.3%	
State Operations (includes deficiencies)	4,667.2	4,903	5,131	5,362	5,592	5,830	6,085	6,351	6,634	5.1%	
Reversions	-35	-25	-25	-25	-25	-25	-25	-25	-25	-28.6%	
Subtotal	**$10,516**	**$11,330**	**$12,103**	**$12,957**	**$13,822**	**$14,440**	**$15,076**	**$15,737**	**$16,442**	**7.7%**	
Capital	$9	$29	$88	$87	$86	$86	$86	$86	$86	205.0%	
Transfers	0	0	0	0	0	0	0	0	0	n.a.	
Reserve Fund	0	122	13	13	14	14	15	16	16	n.a.	
Total Expenditures	**$10,525**	**$11,481**	**$12,204**	**$13,058**	**$13,922**	**$14,540**	**$15,177**	**$15,839**	**$16,544**	**9.1%**	
Surplus (Shortfall)	**188.1**	**-735.7**	**-1,306**	**-1,613**	**-1,888**	**-1,907**	**-1,912**	**-1,906**	**-1,907**	**-491.2%**	
Annual Change		-924	-571	-307	-275	-18	-5	5	-1		
Revenue Stabilization Fund											
Ending Balance	$498	$518	$545	$572	$602	$632	$664	$697	$732		
As a Percent of Revenues	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%		
Ratio of Operating Revenues to Expenditures	0.94	0.91	0.90	0.88	0.87	0.87	0.88	0.89	0.89		

Appendix 1

Operating Budget

Transportation Trust Fund

The Transportation Trust Fund (TTF) is expected to experience moderate growth in its principal revenue sources in the forecast period. Transfers to the general fund generate a greater reliance on debt issuance to maintain capital spending near term and corresponding debt service increases in the out-years.

Fiscal 2003 Closeout

The Transportation Trust Fund (TTF) supports the activities of the Maryland Department of Transportation (MDOT). The TTF closed fiscal 2003 with a special fund balance of $145 million, which is approximately $45 million over the estimated closing balance of $100 million. The higher than anticipated balance is due in large part to the receipt by MDOT of a $33.6 million premium associated with the sale of consolidated transportation bonds during the fiscal year.

MDOT sold an unprecedented $345 million in new debt in consolidated transportation bonds in fiscal 2003, which raised total debt outstanding to $961 million at the end of the fiscal year. A total of $160 million was withdrawn from the TTF and diverted to the general fund. In addition, $17.9 million in overattainment was withdrawn from local highway user revenue grants, which left a total of $433.2 million that was distributed to local jurisdictions.

Fiscal 2004 through 2009 Forecast

For fiscal 2004 through 2009, the Department of Legislative Services' (DLS) TTF forecast projects moderate growth in all revenue sources. Gas tax revenues are projected to increase approximately 2.5 percent in fiscal 2004 and 2005; titling taxes are projected to increase approximately 5.3 percent in fiscal 2004 and 2.2 percent in fiscal 2005, reflecting projections for strong automobile sales in these periods. Current law provides that an additional $155 million is to be withdrawn from the TTF in fiscal 2004 and diverted to the general fund, while a total of $102.4 million is to be diverted from local highway user revenue grants, which is projected to leave a total of $369.6 million for distribution to local jurisdictions.

Exhibit 1 shows that tax and fee revenues are projected to increase from $1.38 billion in fiscal 2004 to approximately $1.5 billion in fiscal 2009, which reflects an annual increase of approximately 1.58 percent throughout the forecast period. The TTF is projected to continue to operate in a strong cash flow position and to maintain a capital program of at least $1.2 billion through fiscal 2006; however, in the out-years the TTF will be increasingly dependent on debt to fund this capital program. Legislative Services' TTF forecast predicts bond sales of $385

Exhibit 1
Transportation Trust Fund Forecast
($ in Millions)

Fund Balance	**Actual FY 2004**	**Estimate FY 2004**	**Estimate FY 2005**	**Estimate FY 2006**	**Estimate FY 2007**	**Estimate FY 2008**	**Estimate FY 2009**	**Total FY 04-09**
Starting Balance	$173	$145	$171	$100	$100	$100	$100	$100
Closing Balance	145	171	100	100	100	100	100	100
Net Revenues								
Taxes and Fees	1,323	1,384	1,418	1,442	1,462	1,480	1,497	8,683
Operating/Misc.	453	468	442	414	398	405	418	2,545
GF Payments/Repayments	-160	-155	0	0	0	0	0	-155
MdTA Transfer	43	43	43	43	43	0	0	172
Net Revenues Subtotal	1,659	1,739	1,903	1,899	1,903	1,885	1,915	11,244
Bonds Sold	345	385	175	165	125	115	90	1,055
Subtotal	2,004	2,124	2,078	2,064	2,028	2,000	2,005	12,299
Expenditures								
Debt Service	130	140	176	155	141	144	157	913
Operating	1,158	1,131	1,194	1,253	1,306	1,358	1,411	7,653
GF/MEDEVAC	0	0	0	0	0	0	0	
Total Capital	777	828	779	656	581	498	437	3,779
Subtotal	2,065	2,099	2,149	2,064	2,028	2,000	2,005	12,345
Debt								
Debt Coverage Ratio – Net Income	4.4	2.6	3.0	4.2	3.7	3.3	2.7	
Debt Outstanding	961	1,252	1,311	1,385	1,441	1,482	1,487	
Highway User Grants	451	472	485	493	499	504	509	2,962
Capital Summary								
State Capital	777	828	779	656	581	498	437	3779
Federal Capital	615	716	618	572	514	414	303	3,137
Total	**$1,392**	**$1,544**	**$1,397**	**$1,228**	**$1,095**	**$912**	**$740**	**$6,916**
Additional (Reduced) Capital Program Based on DLS Forecast			58	44	119	120	-24	317

Note: Sums may not total due to rounding.
Source: Department of Legislative Services

14 *Department of Legislative Services*

million in fiscal 2004 and total bond sales of $1.055 billion through the forecast period. As a result, from fiscal 2007 through 2009, total debt outstanding will be above $1.4 billion. Over the six-year period covered by the forecast, an additional $317 million is made available in the DLS forecast for the capital program over the amount shown in the MDOT draft Consolidated Transportation Program.

Options for Increasing Revenue into the TTF

In June 2003, the Governor appointed a 29-member Transportation Task Force headed by former Secretary of Transportation William K. Hellmann to study transportation needs in the State and identify options for funding future highway, transit, airport, and port projects. The task force estimates that MDOT will have unfunded transportation needs totaling approximately $10.5 billion over the six-year forecast period and has assessed a variety of options for increasing revenue to TTF, including increasing the gas tax, the titling tax, and the vehicle registration fee, and applying the State sales tax to gasoline sales. The task force is expected to report its recommendations for increasing revenues by mid-December 2003. **Exhibit 2** shows the revenue that could be generated by specified increases in each of these taxes and fees.

Exhibit 2
Options for Generating Additional Revenue

Revenue Source	Current Rate	Anticipated FY 05 Revenue at Current Rate	Increase	Net Revenue Increase	Revenue to the TTF	Revenue to Local Jurisdictions
Gas Tax	23.5¢	$752.7 million	1¢	$31.2 million	$20.9 million	$9.4 million[1]
Titling Tax	5%	$720.4 million	1%	$144.0 million	$109.4 million	$34.6 million
Vehicle Registration Fees	$54[2]	$195.0 million	$2 ($1/annum)	$4.4 million	$3.1 million	$1.3 million
Application of State Sales Tax on Gas Sales	5%	None (sales tax is not currently applied to gas sales)	Apply 5% sales tax to retail price of gas	$238.0 million	$238.0 million[3]	

[1] Statutory deductions totaling approximately $.9 million would also be taken from the additional revenue generated by the gas tax increase.
[2] Figure is the cost only of a biennial registration; figure does not include $22 surcharge for the Maryland Institute of Emergency Medical Services Systems or $5 surcharge for the Trauma Physicians Services Fund.
[3] No statute currently governs distribution of revenues generated through the application of the State sales tax to gasoline sales.

Source: Department of Legislative Services

For further information contact: Lucinda D. Lessley Phone: (410) 946/(301) 970-5530

Operating Budget

Federal Funds Outlook

Congress responded to the states' call for aid to help resolve their fiscal crises by disbursing $20 billion as part of the Jobs and Growth Tax Relief Reconciliation Act of 2003. Maryland thus far has received $124 million in June, which created a positive balance sheet for fiscal 2003, and another $90 million in October. However, the annual federal funding process continues the trend of minimal or no increases for State grants in most program areas. An exception is homeland security, which increased by 23 percent nationwide. President Bush's proposed federal fiscal 2004 budget provides approximately 4 percent additional aid to states above fiscal 2003, and Congress' version is likely to offer slightly more. Mandatory programs, however, claim much of the increase. How Maryland will fare in the federal transportation program is unknown as Congress delayed program reauthorization until February.

Budget Delivers Mixed Results

In addition to mounting post-war costs in Iraq, the sobering news that the federal government will incur an estimated $480 billion deficit in 2004 added pressure on Congress to flat fund programs or cut aid below last year's level. The result, so far, is a budget of contradictions. In the House, the Clean Water State Revolving Fund was slashed by 11 percent (though less deeply than the President's proposal), HOME grants for affordable housing were cut below the President's request, and both houses rejected the Administration's substantial increase for weatherization assistance. Yet, the House supported a 7 percent increase in aid for public housing vouchers, and the House and Senate both chose not to eliminate the Brownfields Redevelopment program per the administration's recommendation and instead slightly boosted its funding.

Both the House and Senate trimmed state and local law enforcement aid by 2 to 3 percent below 2003 levels but approved over 20 percent in additional grant money for terrorism prevention and other homeland security programs. Maryland garners $41.5 million, most of which will be distributed to local agencies. Congress also diminished certain appropriations created under the No Child Left Behind Act (innovative program strategies grants, twenty-first Century Community Learning Centers), while enhancing others, such as state assessments.

As of early November, Congress has only sent 4 of 14 appropriations bills to the President (legislative branch, homeland security, defense, and military construction), but unlike last year, when final action was postponed until February, lawmakers plan to complete the fiscal 2004 budget by year's end. The House has reported all 13 bills; the Senate has reported 9. Major legislative proposals with potential fiscal implications for Maryland have either deadlocked in conference (Medicare prescription reform) or were reauthorized at current funding levels (transportation and welfare) pending reconciliation of policy conflicts. For example, the

House endorsed a six-month extension for the Temporary Assistance for Needy Families to allow more time to resolve dramatic differences in the House and Senate approaches to welfare reform. Similarly, the federal six-year transportation program that subsidizes state and local transit and highway projects will operate at current levels until February to give Congress more time to resolve disputes such as indexing the federal gasoline tax.

Exhibit 1 shows appropriations included in the federal fiscal 2004 appropriations bills that Maryland may receive for special projects. The list is not all-inclusive but highlights projects that were passed by one or both houses; their final status will depend on House/Senate conferences, most of which were not completed at publication time.

Exhibit 1

Potential Federal Spending for Maryland

(Fiscal 2004 Appropriations Bills)

Purpose of Funds	**Amount**	
Transportation		
Extension of Metrorail Blue Line from Addison Road to Largo Town Center	$65,000,000	(H/S)
Double tracking for Baltimore's Light Rail	40,000,000	(H/S)
Maryland Bus Program – replacement and improvement of county and rural buses and equipment	7,250,000	(H)
	8,000,000	(S)
Southern Maryland Bus Initiative	5,000,000	(H)
Job Access and Reverse Commute Program	4,000,000	(H)
	5,000,000	(S)
Interstate Route 70 Improvements (Frederick County)	5,000,000	(S)
	770,000	(H)
Upgrade portion of Maryland Route 404 to a four-lane highway	1,000,000	(S)
Magnetic Levitation high-speed rail – pre-construction planning studies	1,000,000	(S)
Intercounty Connector environmental impact study	500,000	(H/S)
Community Development/Infrastructure		
Construction of a new headquarters for the U.S. Census Bureau (Suitland)	146,450,000	(H/S)
Restoration of Fort Washington historic site in Prince George's County	2,724,000	(HSC)
Water infrastructure improvements in five Eastern Shore towns	2,500,000	(S)
Water infrastructure improvements in three Eastern Shore towns	950,000	(H)
Phase I of East Baltimore development − land acquisition, resident relocation, and infrastructure improvements	1,000,000	(S)
Sewer improvements in the Town of Westernport	1,000,000	(S)
Pedestrian linkages in Silver Spring	750,000	(S)
Revitalization of Route 1 in Howard County	500,000	(S)
Facilities rehabilitation in Mt. Rainier Gateway Arts District	200,000	(H)

Purpose of Funds	**Amount**	
Environment		
Poplar Island Beneficial Use Project (wildlife sanctuary)	14,100,000	(H/S)
Chesapeake Bay Gateways Network Program – grants to nonprofits and governments to link resources of the Bay	2,500,000	(HSC)
Chesapeake Bay shoreline erosion study for MD, NY, VA, and PA	400,000	(H)
	500,000	(S)
Study of the decline of the Diamondback Terrapin (State reptile)	200,000	(HSC)
Miscellaneous		
Dredging in the Baltimore Harbor	18,400,000	(H/S)
Beltsville Agricultural Research Center	2,600,000	(H)
	3,000,000	(S)
Baltimore City Drug Enforcement and Eradication Program	2,000,000	(S)

Note: H: House Bill
S: Senate Bill
HSC: House-Senate Conference Report

Sources: Fiscal 2004 Appropriations for Energy and Water Development; Departments of Commerce, Justice, and State; Departments of Transportation and Treasury; Departments of Veterans' Affairs and Housing and Urban Development; Department of the Interior; Maryland Department of Transportation; and the Offices of Senators Barbara Mikulski and Paul Sarbanes and Representative Steny Hoyer.

For further information contact: Ann Marie Maloney Phone: (410) 946/(301) 970-5510

Capital Program

Debt Affordability

The Capital Debt Affordability Committee has preliminarily recommended $650 million in new general obligation debt authorization for fiscal 2005, an increase of $95 million over the 2002 recommendation for 2005. The $650 million, however, is a decrease from the $740 million authorized for fiscal 2004.

Capital Debt Affordability Process

State law requires the five-member Capital Debt Affordability Committee (CDAC) to review the size and condition of all tax supported debt on a continuing basis to help ensure that the State's tax supported debt burden remains affordable. The committee is composed of the Treasurer, the Comptroller, the Secretaries of Transportation and Budget and Management, and a public member. Tax supported debt consists of general obligation (GO) debt, transportation debt, capital leases, Stadium Authority debt, and bond or tax anticipation notes (BANs/TANs). The committee makes annual, nonbinding recommendations to the Governor and the General Assembly on the appropriate level of new general obligation and academic revenue debt for each fiscal year. The committee does not make individual recommendations on the levels of capital leases, transportation debt, or Stadium Authority debt, but it does incorporate the anticipated levels of these types of debt in its analysis of total debt affordability.

The committee's benchmarks for determining whether State debt is affordable are as follows: (1) total tax supported debt outstanding should not exceed 3.2 percent of Maryland personal income; and (2) total debt service on tax supported debt should not exceed 8 percent of revenues. The committee's analysis of debt affordability for the fiscal 2004-2009 period indicates that debt outstanding and debt service ratios will remain within the affordability limits for this period as indicated in **Exhibit 1.**

Exhibit 1
Affordability Ratios
Fiscal 2004 − 2009

Fiscal Year	Projected Debt Outstanding as % of Personal Income	Projected Debt Service as % of Revenues
2004	2.90%	6.17%
2005	2.94%	6.44%
2006	2.92%	6.30%
2007	2.85%	6.16%
2008	2.78%	6.15%
2009	2.78%	6.21%

Source: Capital Debt Affordability Committee

Recommended New Debt Authorization

The Capital Debt Affordability Committee has preliminarily recommended $650 million in new general obligation debt authorization for fiscal 2005. The recommendation is $95 million more than was proposed for fiscal 2005 in last year's report. In the September 2002 report, CDAC proposed a $555 million GO authorization in fiscal 2005. At the CDAC hearings, the administration proposed the increase to accommodate prior spending commitments and the Governor's priorities. The 2005 recommendation is $90 million less than the fiscal 2004 authorization, which totaled $740 million (including $5 million in tobacco buyout financing). The fiscal 2005 recommendation excludes a planned $5 million for tobacco buyout financing, as required by Chapter 103 of 2002. The committee's final recommendation will follow a review of the official December revenue estimates. The Spending Affordability Committee will also make a recommendation in December on the amount of general obligation debt that should be authorized for the coming year. By the end of fiscal 2005, total GO debt is expected to reach $4.6 billion.

The University System of Maryland, Morgan State University, and St. Mary's College have the authority to issue debt for academic facilities as well as debt for auxiliary facilities. Proceeds from academic debt issues are used for facilities that have an education-related function (classrooms, labs, etc.). Debt service for these bonds is paid for with tuition and fee revenues. For fiscal 2005, the Capital Debt Affordability Committee has recommended $33 million for academic facilities on University System of Maryland campuses. This recommendation is $7 million less than the amount recommended and authorized for fiscal 2003.

Transportation bonds are limited obligation instruments, the proceeds of which fund highway and other transportation-related projects. Debt service on these bonds is funded out of motor vehicle fuel taxes, titling and registration fees, a portion of the corporate income tax, and other Department of Transportation revenues. Total outstanding transportation debt is projected to reach $1.4 billion in fiscal 2005.

Capital leases for real property and equipment are secured by the assets leased and are paid with appropriations made to the agencies using the leased items. Debt outstanding for leases is expected to be $137 million at the end of fiscal 2005.

Stadium Authority debt is also limited obligation debt and represents bonds sold for the construction of the Camden Yards baseball and football stadiums, the Baltimore and Ocean City convention centers, and the Montgomery County conference center. Debt service on the stadiums is paid from lottery and Stadium Authority revenues. Debt service on the convention and conference centers is paid from the increased tax revenues received by the State as a result of construction of those facilities. Stadium Authority debt outstanding is expected to be $478 million at the end of fiscal 2005.

For further information contact: Patrick S. Frank Phone: (410) 946/(301) 970-5530

Capital Program

Capital Funding Requests Exceed Resources

Requests for capital project funding again greatly exceed the funding available from general obligation (GO) bonds and pay-as-you-go (PAYGO) funding. In particular, PAYGO funding may be constrained by competing needs for operating funds. GO bond funding is constrained by $30.4 million in "pre-authorized" local projects to be funded in 2005 that were included in the 2004 capital bill.

General Obligation Bonds

The Capital Debt Affordability Committee (CDAC) has preliminarily recommended a $650 million limit on the amount of new general obligation debt authorized for fiscal 2005. While this represents a $90 million reduction from what the CDAC recommended and the General Assembly authorized for fiscal 2004, it is also $95 million more than was planned for fiscal 2005 in last year's recommendation. A portion of the $650 million debt limit is likely to be directed to fund local projects pre-authorized by the General Assembly for fiscal 2005. The Maryland Consolidated Capital Bond Loan of 2003 (Chapter 204), includes two general obligation bond authorizations totaling $30.4 million for local bond bills effective in fiscal 2005. The first authorizes $12.7 million for local projects known as Community Based Regional Initiatives (CBRI) which were initially proposed by the House of Delegates for the fiscal 2003 budget and were re-introduced in the 2003 session. The second authorization provides $17.7 million for local projects referred to as Legislative Community Initiatives of which the Senate will choose $12.7 million in project funding with the remaining $5 million to be mutually agreed upon by both houses. The allocations are summarized in **Exhibit 1**.

Exhibit 1
Pre-authorized Bond Funding for Legislative Initiatives in 2004 Session

		$ in Millions
Community-based Regional Initiatives, House of Delegates Designated in 2003 session		$12.7
Legislative Community Initiatives		17.7
To be designated by Senate	12.7	
To be designated jointly	5.0	
Total		**$30.4**

Despite the increase in the amount of recommended new general obligation debt authorization over the five-year forecast period, general obligation bond funding requests exceed the projected limit by over $1.2 billion. **Exhibit 2** provides a summary of the general obligation bond fund requests and recommended new bond authorizations for the next five fiscal years.

PAYGO Funding

Restrictions imposed under the federal Tax Reform Act of 1986 generally prevent the use of tax-exempt bond proceeds to finance environmental, housing, and economic development revolving loan programs. Funding for these items is therefore typically requested from general and special PAYGO funds. Additionally, repayment to counties for school construction costs already incurred (forward funded construction) must be made with PAYGO or other alternatives to tax-exempt debt. PAYGO also may be used to fund any capital project based on fund availability.

Exhibit 3 shows the requested and planned amount of PAYGO general funds for fiscal 2005 through 2007 as estimated in October 2002 and October 2003, respectively. The figures demonstrate the tempering effect the State's fiscal condition has had on general fund PAYGO requests, as evidenced by the $297.1 million reduction in requests from 2002 to 2003. As would be expected, the requests are primarily constrained to housing and community development and economic development projects that might otherwise need to be funded with taxable bonds. This corresponds with the increase in general obligation bond fund requests as more of the capital program funding is shifted away from PAYGO and into debt.

The baseline budget for fiscal 2005 developed by the Department of Legislative Services includes $28.7 million in general fund PAYGO. **Exhibit 4** compares the fiscal 2004 general fund PAYGO legislative appropriation and the planned level of PAYGO general funds assumed in the 2003 *Capital Improvement Program* (CIP) with the 2005 general fund PAYGO baseline.

The baseline reflects a review of all the projects included in the *Capital Improvement Program* that were planned for general fund support in the 2003 CIP. The baseline assumes a level of total funding that is consistent with the estimate provided in the 2003 CIP for fiscal 2005 for each individual project. General funds were then included in the baseline only to the extent needed to reach the level of planned funding after first accounting for the availability of special funds. Based on these assumptions, the baseline estimate for the amount of PAYGO general funds that may be required to support the capital program in fiscal 2005 is $19.3 million more than was appropriated in fiscal 2004 but $22.4 million less than what was planned in the 2003 CIP. Other than $3.0 million for the Oyster Restoration Program, the baseline only includes estimated PAYGO general funds for housing and community development and economic development projects.

Exhibit 2

GO Bond Requests: Fiscal 2005 – 2009

($ in Millions)

			Fiscal Year				**Category**
	2005	**2006**	**2007**	**2008**	**2009**	**Total**	**Totals**
State Facilities							$454.2
Board of Public Works	$70.0	$102.6	$69.3	$125.1	$82.4	$449.4	
Military	0.0	0.0	0.0	4.1	0.7	4.8	
Health and Social Services							669.0
Health and Mental Hygiene	33.6	21.0	152.3	115.5	103.1	425.5	
University of MD Medical System	10.0	20.0	20.0	25.0	25.0	100.0	
Senior Citizen Activity Center	2.0	1.5	1.5	1.5	1.5	8.0	
Juvenile Justice	9.0	57.9	11.4	26.0	6.2	110.5	
Private Hospital Grant Program	3.5	6.5	5.0	5.0	5.0	25.0	
Environment							416.9
Natural Resources	43.3	40.7	27.0	27.4	28.5	166.9	
Agriculture*	15.6	6.5	7.0	0.0	0.0	29.1	
Environment	36.0	32.2	35.3	35.2	38.3	177.0	
MD Environmental Service	3.3	3.8	3.8	4.0	4.0	18.9	
Education							579.6
Education	0.0	26.5	0.0	16.0	0.0	42.5	
MD School for the Deaf	1.1	5.8	21.3	2.0	0.0	30.2	
MD Public Broadcasting	0.5	0.0	0.7	0.4	17.3	18.9	
Public School Construction	97.6	97.6	97.6	97.6	97.6	488.0	
Higher Education							1,361.1
University System of MD**	174.9	72.4	164.6	129.4	154.2	695.5	
Baltimore City Comm. College	15.2	24.5	6.3	0.2	0	46.2	
St. Mary's College	28.2	3.4	14.4	0.8	15.4	62.2	
Morgan State University	21.1	35.1	45.4	61.8	28.8	192.2	
Community Colleges	61.8	47.1	104.9	61.6	39	314.4	
Southern MD Higher Educ. Center	0.0	0.0	0.8	9.8	0.0	10.6	
Private Facilities Grant Program	8.0	8.0	8.0	8.0	8.0	40.0	
Public Safety							765.4
Public Safety	93.4	124.5	125.5	151.4	171.9	666.7	
State Police	10.7	12.9	0.5	0.0	0.0	24.1	
Local Jails	22.6	26.8	15.7	4.2	5.3	74.6	
Housing and Economic Development							227.1
Economic Development	18.8	24.5	20	20	20	103.3	
Housing and Comm. Development	39.7	13.7	13.1	11.7	11.7	89.9	
Canal Place	0.0	1.5	0.0	0.0	0.0	1.5	
Historic St. Mary's City	5.7	1.7	3.1	13.1	8.8	32.4	
Legislative Initiatives	30.4	15.0	15.0	15.0	15.0	90.4	90.4
Miscellaneous	17.5	16.5	15.5	13.9	10.8	74.2	74.2
Subtotal Request	**$873.5**	**$842.2**	**$997.0**	**$977.7**	**$890.5**	**$4,580.9**	**$4,580.9**
Tobacco Transition Program	5.0	5.0	5.0	5.0	5.0	25.0	25.0
Total Request	**$878.5**	**$855.2**	**$1,010.0**	**$990.7**	**$903.5**	**$4,637.0**	**$4,637.9**
Debt Affordability Limits	**$650.0**	**$665.0**	**$680.0**	**$695.0**	**$710.0**	**$3,400.0**	

*The Department of Agriculture request does not include the Tobacco Transition Program.

**In addition to the GO bond request, the University System of Maryland has requested academic revenue bond funding for fiscal 2005 through 2009 of $66.6 million, $25.9 million, $37.2 million, $25.0 million, and $15.0 million respectively.

Note: Numbers may not sum to total due to rounding.

Source: Department of Budget and Management

Exhibit 3
General Fund PAYGO
Requests vs. Planned
Fiscal 2005 – 2007
($ in Millions)

	Requested As of 10/02	Requested As of 10/03
Agriculture	$21.0	$0.0
Economic Development	177.9	0.0
Canal Place	0.8	0.8
Environment	31.2	20.2
Housing & Community Development	93.7	54.2
Natural Resources	9.0	0.0
Public School Construction	7.8	0.2
Board of Public Works	7.0	4.2
MD Technology Development Corp.	15.0	0.0
University System of Maryland	0.3	0.0
Miscellaneous Grants	13.0	0.0
Total	**$376.7**	**$79.6**

Source: Department of Budget and Management

Exhibit 4
General Fund PAYGO
Fiscal 2004 Legislative Appropriation vs. Fiscal 2005 Baseline
($ in Millions)

	FY 2004 Leg. Approp.	2003 CIP Planned FY 2005 Approp	FY 2005 Baseline	Difference 2004 Leg. Approp. vs. Baseline	Difference 2003 CIP vs. Baseline
State Facilities	$0.0	$0.0	$0.0	$0.0	$0.0
Health/Social	0.0	0.0	0.0	0.0	0.0
Environment	0.0	3.0	3.0	3.0	0.0
Public Safety	0.0	0.0	0.0	0.0	0.0
School Construction	0.0	0.0	0.0	0.0	0.0
Higher Education	0.0	0.0	0.0	0.0	0.0
Housing and Community Development	0.7	18.1	9.7	9.0	(8.4)
Economic Development	8.7	30.0	16.0	7.3	(14.0)
Local Projects	0.0	0.0	0.0	0.0	0.0
Total	**$9.4**	**$51.1**	**$28.7**	**$19.3**	**($22.4)**

Source: Department of Legislative Services

For further information contact: Matthew D. Klein Phone: (410) 946/(301) 970-5530

Revenues and Taxes

Comparative Tax and Revenue Rankings

Maryland State and local government revenues are not high in comparison to other states. However, Maryland relies more on taxes than most states and less on non-tax sources of revenue. While the total burden of all taxes in Maryland is quite moderate when measured in terms of the State's economy, it appears significantly higher when measured on a per capita basis. Under any measure, Maryland's tax structure relies more heavily on the personal income tax than other states.

State and Local Government Spending

As reflected in **Exhibit 1**, compared to other states, total State and local government revenues and spending in Maryland are not high. Maryland ranks generally in the middle of all states in total State and local government revenues and spending measured on a per capita basis and near the lowest in revenues and spending as a percent of personal income of residents. However, Maryland relies more than most states on taxes and less on non-tax sources of revenue.

Exhibit 1

Maryland State and Local Government Spending and Revenues: 1999-2000[1]

	MD Rank Percent of Total	MD Rank Per Capita	MD Rank Percent of Personal Income
Total Spending	n/a	26	47
Total Revenues	n/a	21	48
Revenues			
Taxes	3	10	30
Intergovernmental from Federal Government	44	43	47
Charges and Utilities[2]	42	36	47
Miscellaneous[3]	28	29	44

Note: For the rankings, 1 indicates the highest and 51 the lowest.

[1]For comparability purposes, public hospital revenues and spending were excluded from this analysis.

[2]Charges include higher education tuition, fees and auxiliary revenues, sewer and trash collection, highway tolls, and other user charges and fees. Utilities include gross receipts of publicly owned utilities (water, gas, electric, and transit).

[3]Miscellaneous revenues include interest earnings, net lottery revenues, liquor store revenues, rents, royalties, fines and forfeitures, special assessments, sale of property, and other.

Source: Government Finances, 1999-00, U.S. Bureau of the Census (January 2003)

State and Local Taxes Compared to Neighboring States

Exhibits 2 and 3 compare Maryland's State and local tax revenues to other states in the region. Maryland's reliance on the income tax is high compared to other states, reflecting the statewide local income tax. Maryland ranks thirtieth among all states in overall State and local tax revenues as a percent of personal income and tenth in overall taxes on a per capita basis. Generally, Maryland ranks in the middle with respect to property taxes and near the bottom with respect to corporate income taxes and sales taxes, measured either on a per capita or percentage of income basis.

Exhibit 2
Maryland State and Local Tax Revenues – Comparison to Selected States
1999-2000 Tax Revenues as a Percent of Personal Income

	Property Tax	Personal Income Tax	Corporate Income Tax	Sales & Selective Taxes[1]	License Fees	Other Taxes[2]	All Taxes
District of Columbia							
Percent	3.1%	4.9%	1.2%	4.5%	0.2%	0.6%	14.5%
Rank	22	1	2	15	48	10	1
New Jersey							
Percent	4.6%	2.3%	0.4%	2.6%	0.3%	0.3%	10.5%
Rank	4	35	18	44	43	33	24
Maryland							
Percent	**2.7%**	**4.0%**	**0.2%**	**2.6%**	**0.2%**	**0.5%**	**10.3%**
Rank	**33**	**4**	**38**	**45**	**45**	**17**	**30**
Virginia							
Percent	2.7%	3.1%	0.3%	2.7%	0.3%	0.5%	9.5%
Rank	32	17	36	43	40	19	43
Delaware							
Percent	1.6%	3.2%	1.0%	1.2%	3.2%	0.6%	10.7%
Rank	49	13	3	50	1	14	19
Pennsylvania							
Percent	2.8%	2.6%	0.5%	3.0%	0.6%	0.7%	10.1%
Rank	30	26	16	41	11	8	36
North Carolina							
Percent	2.1%	3.3%	0.6%	3.3%	0.4%	0.2%	9.9%
Rank	42	12	11	37	34	40	41
West Virginia							
Percent	2.2%	2.5%	0.6%	4.7%	0.4%	0.8%	11.1%
Rank	41	34	10	11	24	5	15
U.S. Average	**3.0%**	**2.5%**	**0.4%**	**3.7%**	**0.4%**	**0.4%**	**10.5%**

Note: For the rankings, 1 indicates the highest. Rankings are out of 51 except for the personal income tax (out of 44) and the corporate income tax (out of 47). If the rank is "n.a.," the state does not have that tax.

[1] Includes the general sales tax along with selective taxes such as excise taxes on alcohol and tobacco products, motor fuel taxes, titling taxes, admissions and amusement taxes, insurance premiums taxes, public utility gross receipts taxes, and others.

[2] Includes death and gift taxes, documentary and stock transfer taxes, severance taxes, and other taxes.

Source: Government Finances, 1999-00, U.S. Census Bureau (January 2003)

Exhibit 3
Maryland State and Local Tax Revenues – Comparison to Selected States
1999-2000 Tax Revenues Per Capita

	Property Tax	Personal Income Tax	Corporate Income Tax	Sales & Selective Taxes[1]	License Fees	Other Taxes[2]	All Taxes
District of Columbia							
Amount	$1,211	$1,883	$457	$1,748	$76	$247	$5,622
Rank	9	1	2	4	44	5	1
New Jersey							
Amount	$1,717	$860	$160	$978	$94	$93	$3,903
Rank	1	15	11	31	39	26	4
Maryland							
Amount	**$908**	**$1,351**	**$81**	**$873**	**$72**	**$169**	**$3,454**
Rank	**20**	**4**	**30**	**40**	**45**	**14**	**10**
Virginia							
Amount	$846	$965	$80	$843	$90	$155	$2,978
Rank	25	12	32	42	40	16	23
Delaware							
Amount	$488	$988	$307	$380	$991	$187	$3,340
Rank	44	11	4	50	1	8	13
Pennsylvania							
Amount	$820	$756	$138	$882	$185	$197	$2,979
Rank	29	22	14	39	6	7	22
North Carolina							
Amount	$572	$896	$149	$895	$94	$58	$2,664
Rank	40	13	13	38	38	42	32
West Virginia							
Amount	$473	$534	$120	$1,016	$97	$173	$2,413
Rank	45	36	17	27	36	13	43
U.S. Average	**$885**	**$752**	**$128**	**$1,099**	**$121**	**$115**	**$3,100**

Note: See notes in Exhibit 2

Source: Government Finances, 1999-00, U.S. Census Bureau (January 2003)

Expansion of the Sales Tax to Services

Expanding the sales tax base to include more services has been suggested as a way to provide significant new revenue for the State and improve State tax policy. The theoretical benefits of taxing services more broadly include increased reliability of revenues from the tax and enhanced equity among taxpayers. The revenue that could be generated from taxing services, as well as the tax policy implications, depends on the services that are included in the base.

Background

Maryland's sales and use tax, originally enacted in 1947, is the State's second largest source of general fund revenues, accounting for $2.7 billion in fiscal 2003. Historically, the sales and use tax has been imposed broadly on the sale or use of tangible personal property, but only narrowly on a few specifically enumerated taxable services. Over the past few decades, the growth in sales and use tax revenues has not kept pace with the growth in personal income, as the tax base has eroded due to several factors. One major contributing factor cited for the erosion of the sales tax base is a major shift that has occurred in the national economy from consumption of goods, the traditional base of the tax, to consumption of services. Broadening the sales tax base by imposing the tax more broadly on services has been suggested as a way to provide better balance in the State's tax structure, to make the sales tax more reflective of the economy as a whole, and to improve the stability, neutrality, and horizontal equity of the tax.

Current Taxation of Services

Under current law, only a handful of specifically enumerated services are defined as "taxable services" subject to the Maryland sales and use tax. These include, among others, wireless telecommunications services, security services, commercial building cleaning services, credit reporting services, and pay-per-view television. Although they are not considered services under the sales and use tax, the tax also applies generally to such things as rentals of tangible personal property, restaurant meals, hotel rooms, and utilities (although specific exemptions are allowed for residential purchases of electricity and gas).

Maryland's limited taxation of services under the sales and use tax is not unique. About half of the states that impose sales taxes essentially do not tax any services other than utilities, rentals of property, restaurant meals, hotel rooms, and admissions and amusements. Only five states (including two that impose gross receipts taxes on businesses that are not technically sales taxes) have taxes that generally apply to all services. About 10 states impose the sales tax broadly on services related to tangible personal property, such as fabrication, installation, and repair services. Several states also tax at least a few other personal services, and a few states also tax some business services.

Among surrounding jurisdictions, New Jersey, Pennsylvania, West Virginia, and the District of Columbia tax a broad range of repair services, including automotive repairs. Pennsylvania and West Virginia also tax some business services, and West Virginia also taxes some personal services. Delaware, which does not have a sales tax, is considered to have a broad taxation of services under its gross receipts tax, which applies to most businesses.

Growth of the Service Economy

One of the principle arguments cited for taxing services more broadly under the sales tax is based on the shift in household spending over the past few decades from goods to services. Based on personal consumption expenditure data from the U.S. Department of Commerce, expenditures on services rose from 48 percent of total personal consumption expenditures in 1980 to 59 percent in 2002, while spending on goods fell as a percentage of total consumption. Average annual growth in expenditures was 7.7 percent for services versus 5.5 percent for goods over the same period. If more of the services component of the economy were included in the sales and use tax base, revenues would increase, and the revenue growth from the tax would more closely track the growth in personal income of Maryland residents.

However, a consideration of the components of the service economy shows that it may not be feasible or desirable to tax many of the major components of consumer expenditures for services. Two categories of services not typically considered for expanded sales taxation comprised more than half of all service expenditures in 2002: medical care (26.6 percent) and housing (24.8 percent). The next largest category, personal business services (15.4 percent), is largely made up of personal financial services, including imputed expenses (e.g., "free" checking in lieu of market interest on a bank account) that could be impractical to tax. The next largest category, household operations (9.4 percent), includes household utilities as a major component. Electric and gas utilities are already technically subject to the Maryland sales and use tax, while specific exemptions are allowed for residential utilities. Wired telephone service is subject to a two percent gross receipts tax under the public service company franchise tax, while wireless telephone service is already subject to the sales tax. The remaining expenditure categories likewise include significant components that are either already subject to the sales tax (e.g., rental of automobiles, included under the transportation category) or for practical or policy reasons are not likely to be taxed (e.g., religious and welfare activities).

Not reflected in the personal consumption expenditures data are business-to-business sales of services. While presenting the potential for tremendous revenue enhancement from the sales and use tax, taxing business-to-business sales of services would present several tax policy disadvantages, including "tax pyramiding" that could lead to inequities in treatment of different products or services, anti-competitive effects for Maryland-based businesses and for small businesses in particular, and distortion of rational business decision making.

Corporate Income Tax Reform

A recent decision of the Maryland Court of Appeals will aid the Comptroller in collecting taxes from Delaware holding company (DHC) affiliates of Maryland firms. House Bill 753 of 2003, which passed the General Assembly but was vetoed by the Governor, included provisions to limit the ability of Maryland firms to avoid the Maryland income tax by using Delaware holding companies. The fiscal impact of such "loophole closing" measures is difficult to determine, because the extent to which these tax avoidance strategies are used is not known and the recent court decision has not been finally resolved or tested.

Delaware Holding Companies Held Liable for Corporate Tax

In a decision filed June 9, 2003 *(Comptroller of the Treasury v. SYL, Inc., Comptroller of the Treasury v. Crown Cork & Seal Company (Delaware) Inc.)*, the Maryland Court of Appeals ruled that two corporations doing business in Maryland could not use Delaware holding companies to shelter income earned in Maryland from the Maryland income tax. The court found that even though the two subsidiary corporations did no business in Maryland, other than licensing intellectual property for use in Maryland, and owned no tangible property in Maryland, there was a sufficient nexus between the State and the two out-of-state subsidiary corporations so that the imposition of the Maryland income tax does not violate either the Commerce Clause of the U.S. Constitution or principles of due process.

The two cases before the court involved the Comptroller's assessment of tax liability against so-called Delaware holding companies, out-of-state subsidiaries established in Delaware by companies operating in Maryland to hold and manage intangible assets. Because Delaware does not tax such companies on the income generated by trademarks, intellectual property, and other intangible assets, Delaware holding companies have been used by Maryland operating companies to attempt to shelter income from the Maryland corporate income tax. Companies seek to reduce state income tax liability in Maryland and other states by putting intangible assets such as trademarks and other intellectual property in a corporate subsidiary in Delaware. The Maryland operating company then pays the subsidiary for the right to use the trademarks or other intangible assets, resulting in an expense deduction for the Maryland operating company that reduces its Maryland taxable income.

The Court of Appeals held that an appropriate portion of the income of each of the Delaware holding companies was subject to Maryland income tax. The court found that the Delaware holding companies had "no real economic substance as separate business entities" and that "sheltering income from state taxation was the predominant reason for the creation" of the out-of-state subsidiaries.

The amount involved in these two cases was a little over $2 million, representing tax assessments against these two Delaware holding companies for tax years between 1986 and 1993. The decision, however, has implications for over 70 cases pending or scheduled for hearings before the Tax Court, involving approximately $34 million in tax assessments for prior tax years, as well as several dozen other related cases that are currently under administrative review by the Comptroller. On November 3, the U.S. Supreme Court denied the petition of

SYL, Inc., to review its case. Crown Cork and Seal Company has also sought Supreme Court review of its case. While some of the pending cases may settle as a result of the Court of Appeals decision, others may wait until final resolution of the two cases.

Proposed Legislative Changes Could Affect Corporate Tax Liabilities

House Bill 753 from the 2003 session, passed by the General Assembly but vetoed by the Governor, would have limited the ability of Maryland companies to use Delaware holding companies to shift income out of the State. House Bill 753 would have required that, for purposes of determining Maryland taxable income, a corporation must add back to federal taxable income any otherwise deductible interest expense or intangible expense paid to related corporations, except under specified parameters, including a requirement that the transaction not have as a principal purpose the avoidance of tax. House Bill 753 also included two other changes in the determination of corporate tax liability, by imposing a "throwback rule" and requiring the allocation to Maryland of nonoperational income of Maryland firms.

Potential Revenue from Closing Loopholes Is Uncertain

The fiscal impact of these "loophole closing" measures is difficult to determine because the extent to which these tax avoidance strategies are used is not known and the recent court decision has not been tested with other taxpayers. Last year, the Department of Legislative Services estimated that the income tax revenue loss to the State resulting from the use of Delaware holding companies could range from $20 to $150 million annually. For purposes of the budget-balancing package of revenue measures passed by the General Assembly, it was conservatively estimated that the Delaware holding company provisions and other corporate tax changes included in House Bill 753 would generate a minimum of $35 million in additional general fund revenues in fiscal 2004. The Multistate Tax Commission produced a study this summer examining the nationwide impact of these tax avoidance strategies. For Maryland, it estimated a revenue of $75 million to $161 million. The commission estimated an additional State tax loss of $90 million attributable to international tax sheltering.

Regarding the cases subject to challenge or review by the Comptroller's office, prospective or retrospective revenues have not yet been incorporated into the State revenue forecast, pending developments with the primary cases.

For further information contact: Matthew D. Riven Phone: (410) 946/(301) 970-5510

Revenues and Taxes

Video Lottery Terminals: Issues and Options for Maryland

Video lottery terminals (VLTs) have been proposed as a means to provide a significant new revenue source for the State and to assist Maryland's horse racing industry. Legislation providing for VLTs at the State's tracks was proposed last session by the Governor, and amended and passed by the Senate. The House opted to study the issue this interim. Other states with legal VLTs have structured their revenue distribution arrangements in a variety of ways.

Senate Bill 322 of 2003 and Other Video Lottery Terminal Legislative Initiatives

Overview

Introduced as an Administration bill and passed by the Senate, Senate Bill 322 would have authorized VLTs at four racetrack locations in the State.

As introduced, SB 322 (crossfiled with House Bill 359) would have authorized up to 11,500 VLTs at up to four horse racing tracks in the State, provided for one-time license fees, abolished the State Lottery Agency and State Racing Commission and established the State Lottery and Horse Racing Agency and Commission, created an Education Trust Fund and other special funds, and continued the current prohibition on additional forms of commercial gaming.

As amended and passed by the Senate, the bill would have authorized 3,500 VLTs each at Pimlico Racecourse in Baltimore City, Laurel Park in Anne Arundel County, and Rosecroft Raceway in Prince George's County. An additional 1,000 VLTs would have been authorized at a proposed track in Allegany County.

Major Provisions

Under Senate Bill 322 as amended, VLT regulation and oversight would have been carried out by the State Lottery Commission. The VLTs would have been owned or leased by the State Lottery Commission and under the control of the commission at all times. An applicant for a VLT operation license and a VLT licensee would also have been required to:

- pay a one-time application fee of $5 million ($1.5 million for the Allegany track);
- invest at least $150 million in construction and related costs and provide at least 500 full-time jobs (the Allegany track would have had to invest $43 million and provide at least 150 jobs);

- offer at least 15 percent of equity investment to minority businesses if the licensee holds one license and 10 percent if the licensee holds two or more licenses and meet the State's minority business participation requirements for facility construction and procurement and the relevant county's minority business participation requirements, if they are higher than the State's; and

- maintain a specified number of live horse racing days at each horse racetrack location and develop a racing improvement plan to improve the quality and marketing of horse racing at each track that included $4 million in capital maintenance and improvements in the horse racing facilities.

Furthermore, if a VLT operation license were granted to Pimlico and Laurel Park, both licenses would have been revoked if the Preakness was transferred out of the State.

Revenue Distribution

Under SB 322 as amended, gross proceeds, after prize payouts, would have been distributed as follows:

- 46 percent to an Education Trust Fund established under the bill;
- 5 percent to the State Lottery Agency for administrative costs (after the first year, the distribution would be 4.3 percent);
- 39 percent to VLT operation licensees;
- 4.75 percent for local development grants to the local governments in which video lottery facilities would be located; and
- 5.25 percent to the Purse Dedication Account established under the bill to enhance racing purses and to provide funds for the horse breeding industry (after the first year, the distribution would have increased to 5.95 percent).

Additional fees for a Compulsive Gambling Fund, administered by the Department of Health and Mental Hygiene, would have been assessed on VLT operation licensees. The fund would have been used to establish a 24-hour hotline, provide counseling and other support services for compulsive gamblers, and establish problem gambling prevention programs.

The Department of Legislative Services (DLS) estimated that approximately $1.3 billion in gross proceeds (after prize payouts) could have been generated once all the proposed VLTs were operating at full market potential (estimated to occur in fiscal 2008). Once fully operational, annually the VLTs could have generated approximately $600 million for the Education Trust Fund, $500 million for the racetracks, $62 million for local governments, and $77 million for the Purse Dedication Account.

Other Legislation Related to VLTs

Several other bills would have authorized VLTs in the State, including House Bill 78/Senate Bill 699, House Bill 890, and Senate Bill 446. Additionally, House Bill 1122 (emergency bill) would have required that a special election be held in the county in which a video lottery facility is to be located before an owner of a video lottery facility offers VLTs for public use.

House Ways and Means Committee Study of Video Lottery Terminal Issues

After the failure of Senate Bill 322 in the Ways and Means Committee, the committee has undertaken an interim study of issues related to the legalization of VLTs in Maryland. The committee began its study with two meetings in Annapolis in July and August. At the July meeting, members were briefed by DLS on VLT legislation from the 2003 session, current gambling activities in Maryland, Maryland's tax structure, and the State's fiscal outlook. In August, the committee heard from the American Gaming Association (a casino advocacy organization); the University of Maryland, Baltimore County; representatives of the horse racing industry; and groups opposed to the expansion of gambling in the State.

In September, the committee began a series of four public hearings around the State to receive input on VLT issues. The hearings are being held in Prince George's County, Baltimore City, on the Eastern Shore, and in Western Maryland. In November and December, the committee will hold further meetings in Annapolis to discuss its findings and potential recommendations, in anticipation of again considering VLT legislation during the 2004 session.

VLTs in Other States

Of the surrounding states, Delaware and West Virginia currently allow VLTs. In Delaware, VLTs generated approximately $524 million in gross proceeds (after prize payouts) in fiscal 2003, while VLTs in West Virginia generated approximately $890 million in gross proceeds last year, of which $717 million was generated by VLTs at racetracks and another $173 million from VLTs located in bars. Pennsylvania is considering legislation to authorize VLTs.

Exhibit 1 indicates the approximate distribution of VLT gross proceeds (after payout) in selected states with VLT operations and indicates the wide range of structures that have been implemented.

Exhibit 1
Approximate Distribution of VLT Revenues in Selected States

	Connecticut	Delaware[1]	Illinois[1]	New York	Nevada	Rhode Island
State	25.0%[2]	35.0%	30.0%	61.0%	7.2%[3]	60.0%[4]
Lottery				10.0%		
Licensee		49.0%	64.0%	20.0%		26.8%
Central System/ Machine Vendors		5.0%				9.5%
Local Governments			6.0%			1.0%
Horse Racing (purses, breeders, etc.)		11.0%		9.0%		3.7%[5]

[1] Percentages shown are effective distribution for fiscal 2003; statutory distribution is based on sliding scale.
[2] Indian Casinos pay 25 percent of gross slot machine win to the state on a monthly basis.
[3] Taxes from slots only – table games excluded.
[4] Includes a distribution to the Lottery Commission.
[5] Owners of dog kennels under contract with licensee.

Source: Department of Legislative Services

Personnel

State Workforce and Payroll

The fiscal 2004 budget imposed a limit on the total number of regular and contractual State positions, resulting in a second year of position reductions. The budget bill also allowed the addition of up to 250 State-funded positions and unlimited non-State funded positions. Payroll and fringe benefits cost $5.4 billion, about 24 percent of the total State budget.

Budgeted Positions

Regular Employees

Section 41 of the fiscal 2004 budget bill (Chapter 202 of 2003) established a limit of 74,100 on the number of regular full-time equivalent (FTE) employees that may be employed by Executive Branch agencies, 1,500 FTE positions fewer than the limit established for fiscal 2003. Primarily due to the use of a hiring freeze, Executive Branch position caps, and elimination of vacant positions from fiscal 2003 to 2004, the regular employee workforce fell by 2,728.6 FTEs by November 2003. Approximately 91 percent of the change can be accounted for by 11 out of a possible 22 agencies or service areas, as shown in **Exhibit 1**. Since fiscal 2002, the year before position caps were first implemented, a total of 3,999.5 FTEs have been abolished.

Fiscal 2004 Additions and Abolitions

Another section of the budget bill, Section 19, allows the addition of up to 250 regular State-funded positions by the Board of Public Works (BPW) and is commonly referred to as the "Rule of 250." These 250 positions may include as many as 250 contractual conversions (requiring the abolition of 1.25 FTE contractual positions per conversion). In addition, Section 19 permits BPW to create positions above the 250-position limit under specific circumstances, including when those positions are entirely supported by funds from federal or other non-State sources in any agency. Section 19 also requires that when these non-State funds are no longer available, the position be eliminated. Thirty-seven positions have been added under this mechanism. Transfers, additions, and abolitions since the beginning of fiscal 2004 are described in **Exhibit 2**.

Exhibit 1
Regular Full-time Equivalent Positions
Fiscal 2002 Actual to 2004 Working Appropriation

Agency/Service Area	2002 Actual	2003 Actual	2004 Working Approp.	Change: 2003 to 2004 Working	Cumulative % of Total Change
Health & Mental Hygiene	8,535.8	8,211.9	7,701.8	(510.1)	18.7%
Higher Education	21,386.2	21,402.5	20,966.2	(436.4)	34.7%
Human Resources	8,272.6	7,729.1	7,381.1	(348.0)	47.4%
Public Safety & Correctional Services	11,662.5	11,562.5	11,231.0	(331.5)	59.6%
Transportation	9,538.0	9,318.5	9,095.5	(223.0)	67.8%
MSDE & Other Education	1,955.0	2,018.6	1,883.9	(134.7)	72.7%
Natural Resources	1,629.2	1,577.2	1,454.0	(123.2)	77.2%
Labor, Licensing, & Regulation	1,706.0	1,617.0	1,519.1	(98.0)	80.8%
Police & Fire Marshal	2,589.5	2,572.5	2,479.5	(93.0)	84.2%
General Services	793.0	806.5	714.0	(92.5)	87.6%
Environment	1,028.0	1,032.0	951.0	(81.0)	90.6%
Other Executive Branch	9,251.4	9,013.8	8,756.6	(257.2)	100.0%
Subtotal Executive Branch	**78,347.1**	**76,862.1**	**74,133.6***	**(2,728.6)**	
Judicial and Legislative Branch	3,739.8	3,953.8	3,953.8		
Total	**82,086.8**	**80,815.9**	**78,087.3**	**(2,728.6)**	

* Includes 37 FTE positions added through the Rule of 250.

Source: Department of Budget and Management

The Department of Budget and Management is required under Section 41 of the fiscal 2004 budget bill to propose a plan for elimination of positions necessary to reach the fiscal 2004 cap of 74,100 Executive Branch positions. With the abolitions noted in Exhibit 2, and excluding positions added through the Rule of 250, the Executive Branch workforce is 3.4 FTEs smaller than required.

Exhibit 2
Regular Full-time Equivalent Positions
Fiscal 2004 Position Adjustments

Agency/Service Area	2004 Legis. Approp.	BPW Additions, Transfers, & Adjustments	Total BPW Abolitions	2004 Working Approp.
Legislative	730	0	0	730
Judiciary	3,224	0	0	3,224
Legal	1,469	0	-25	1,444
Executive & Administrative Control	1,594	0	-26	1,568
Financial & Revenue Administration	2,086	0	-57	2,030
Budget & Management	491	18	-37	472
Retirement	185	0	-4	181
General Services	774	0	-60	714
Transportation	9,319	0	-223	9,096
Natural Resources	1,490	1	-37	1,454
Agriculture	439	3	-11	431
Health & Mental Hygiene	7,895	4	-197	7,702
Human Resources	7,606	0	-225	7,381
Labor, Licensing, & Regulation	1,549	9	-39	1,519
Public Safety & Correctional Services	11,304	2	-75	11,231
MSDE and Other Education	1,921	1	-38	1,884
Housing & Community Development	407	0	-14	393
Business & Economic Development	309	0	-10	299
Environment	975	0	-24	951
Juvenile Services	1,961	1	-23	1,939
Police & Fire Marshal	2,494	0	-14	2,480
Subtotal	**58,220**	**39**	**-1,137**	**57,121**
Higher Education	21,509	0	-543	20,966
Total	**79,729**	**39**	**-1,680**	**78,087**

[1]Includes positions added under Section 19 of the fiscal 2004 budget bill, "casual" transfers between agencies, and two FTE positions added to the Maryland Parole Commission under authority of Senate Bill 507 (Chapter 96 of 2003).

Source: Department of Budget and Management

Contractual Employees

Section 41 of the budget bill also requires that the number of contractual positions in Executive Branch agencies be limited in fiscal 2004 to the same level provided in fiscal 2003. This limit is set at 8,800 FTEs and required the abolition of 371 FTE Executive Branch contractual positions from the number of positions available on July 1, 2003. The resulting total of contractual positions is 95.7 FTEs below the cap, or 9,076.4 FTEs, including the 372 FTE contractual positions in the Judiciary.

Average Salaries and Expenditures

The budgeted expenditure per regular FTE position in fiscal 2004 is approximately $62,800 (of this amount, $45,600 is attributable to salary and $17,200 is the attributable to fringe benefits). Fringe benefits include health insurance, retirement benefits, social insurances (Social Security, unemployment insurance, workers' compensation), and some discretionary employee benefits. In past years discretionary benefits included a State match for deferred compensation, a bonus for above average job performance, a transit benefit, and tuition waivers. In fiscal 2004, tuition waivers are budgeted within agencies; the cost of the employee transit benefit is absorbed by the Maryland Department of Transportation. Performance bonuses and the match for deferred compensation are not available due to budget constraints. The expenditure per contractual position in fiscal 2004 is approximately $42,100, primarily to be used for salaries. Social Security, workers' compensation, and unemployment insurance are also paid on behalf of contractual employees. Overall, the State has budgeted approximately $5.4 billion for salaries and benefits for 87,163.7 FTE regular and contractual positions.

Employee Health Insurance

While health insurance costs face double-digit inflation nationally, the State's premium costs are expected to increase only by 8.9 percent from fiscal 2004 to 2005, with costs totaling $727.8 million. While State health care utilization is increasing, overfunding in fiscal 2004 and the abolition of State positions have mitigated premium increases for fiscal 2005.

Background

The State offers a variety of health plans, many on a pre-tax basis, to State employees, retirees, and their qualifying dependents. Eligible individuals may choose from among two preferred provider options (PPO), three point-of-service (POS) plans, and three health maintenance organization (HMO) plans for their medical coverage. In addition, the State offers insurance coverage for mental health/substance abuse, prescription drugs, dental care, term life insurance, accidental death and dismemberment insurance, and long-term care.

The State has traditionally subsidized all or part of health insurance premiums for employees and retirees. The State contributes toward the cost of employee coverage as follows: 80 percent for PPO plans, 85 percent for POS and HMO plans, 80 percent for prescription drugs, and 50 percent for dental care. The State does not contribute for term life insurance, accidental death and dismemberment insurance, or long-term care. The State contributes the same subsidy percentages for retirees who have at least 16 years of creditable service.

Large Increase in Health Insurance Costs Expected Nationwide

Nationally, premiums for employer-sponsored health insurance increased almost 14 percent between spring 2002 and spring 2003 – the highest increase since 1990. Some estimates indicate that nationally, employees' health insurance premiums are expected to increase by an average of 22 percent this year over last.

While premium increases have been fueled by higher prescription drugs costs in recent years, utilization in all categories has increased substantially. Individuals are using more prescription drugs, but are also having more visits to the doctor's office, and are having approximately 20 percent more outpatient procedures per person over the last five years than in prior years. This increase in demand is driving up health care costs in all categories, including hospitalization, pharmaceutical, and physician services. It is estimated that two thirds of the increase in health insurance premiums is due to the public's demand for more health care services.

State Health Insurance Premiums Increase Much More Slowly than National Average

In total, State subsidies are anticipated to increase by approximately 8.9 percent in fiscal 2005. As illustrated in **Exhibit 1**, the fiscal 2004 appropriation was larger than necessary to cover actual health expenditures. Additionally, the number of State employees has declined due to the abolition of State positions during fiscal 2004. Both of these circumstances lessen the fiscal impact of premium increases for fiscal 2005.

Exhibit 1
State Subsidies of Employee and Retiree Health Insurance Premiums
($ in Millions)

	FY 2004	FY 2005	Increase	% Increase
PPO Health Plans	$206.1	$218.6	$12.5	6.1%
POS Health Plans	160.3	176.8	16.5	10.3%
HMO Plans	60.3	69.9	9.6	15.9%
Prescription Plan	223.1	244.2	21.1	9.5%
Dental Plans	11.8	12.3	0.5	4.4%
Administrative Costs	6.5	6.0	-0.5	-7.6%
Total Cost	**668.1**	**727.8**	**59.7**	**8.9%**
Total Appropriation	**680.8**	**727.8**	**47.1**	**6.9%**
Difference	**-12.7**	**0.0**	**0.0**	**0.0%**

Source: Department of Legislative Services

Language in the 2003 *Joint Chairmen's Report* required the Department of Budget and Management to examine cost-savings options for prescription drugs, including increased copays. For calendar 2004, however, there will be no change in the level of copays for employees and retirees. **Exhibit 2** illustrates the increases to the various insurance options available to employees and retirees.

Exhibit 2
State Employee Premium Rates for Calendar 2004
Single Person Coverage Rate

Medical Plans	2003 Biweekly Employee Premium	2004 Biweekly Employee Premium	Percent Increase 2003 – 2004
CareFirst of MD PPO	$31.64	$33.30	5.2%
MLH Eagle PPO (MAMSI)	32.56	33.17	1.8%
Aetna Quality POS	17.51	21.74	24.1%
CareFirst of MD POS	19.17	20.45	6.7%
MDIPA POS (MAMSI)	18.46	20.77	12.5%
Blue Choice HMO (CareFirst)	16.90	17.17	1.6%
Kaiser Permanente HMO	15.79	16.05	1.6%
Optimum Choice HMO (MAMSI)	15.87	16.13	1.6%
Advance PCS (Rx Drug Plan)	16.04	17.09	6.5%

Source: Department of Budget and Management

Funding for State Retiree Health Benefits

The State currently partially subsidizes retiree health insurance benefits as it does for current State employees. Like most other states, Maryland currently funds this subsidy on a "pay-as-you go" basis. The State's actuary has informally estimated the liabilities associated with this subsidy to be approximately $3 billion. Future liabilities are expected to continue to increase from the growing number of retirees and the escalation in health care costs.

The Governmental Accounting Standards Board (GASB) issued an exposure draft in 2003 proposing new accounting standards for states' retiree health benefits liabilities. GASB believes that retiree health benefits are a part of the compensation that employees earn each year, even though these benefits are not received until after employment has ended. Therefore, the cost of these future benefits is part of the cost of providing public services today. Instead of funding retiree health benefits on a pay-as-you-go basis, the proposed standards will require states to account for their long-term financial obligations.

Pension Investment Performance and Impact on State Contribution Rates

The State Retirement and Pension System of Maryland earned a 3.2 percent investment return for fiscal 2003. The contribution rates for the employees' and teachers' systems remain unchanged for fiscal 2005, based on the "corridor" approach enacted in 2002. Absent significant investment gains in 2004, these systems are likely to fall out of the corridors next year, resulting in higher pension contributions in 2006. Actions taken by the General Assembly, as well as those initiated by the pension board, should help to address the board's governance and management problems.

Fiscal 2003 Investment Results and Impact on System Actuarial Funding

The State Retirement and Pension System of Maryland (SRPS) earned a 3.2 percent investment return for fiscal 2003. The State's pension system is 92.9 percent funded on an actuarial basis and remains actuarially sound. For reasons discussed below, the aggregate State employer contribution rate will decrease from 8.06 percent of payroll for fiscal 2004 to 7.97 percent of payroll for fiscal 2005. **Exhibit 1** lists the new contribution rates and actuarial funding levels by individual system.

Exhibit 1
Fiscal 2004 and 2005 Employer Contribution Rates

Plan	FY 2004 Rate	FY 2005 Rate	Actuarial Funding Level
Employees	4.73%	4.73%	91.6%
Teachers	9.35%	9.35%	92.8%
State Police	7.58%	0.00%	121.0%
Judges	43.74%	36.72%	86.1%
Law Enforcement Officers	35.13%	37.73%	60.5%
Aggregate	**8.06%**	**7.97%**	**92.9%**

Note: Funding levels reflect State funds only and exclude any municipal contributions or funds.

Source: Milliman USA

Pension "Corridor" Funding Methodology

The General Assembly took action during the 2002 legislative session under the Budget Reconciliation and Financing Act (Chapter 440 of 2002) to reduce the budgetary impact of volatile pension investment performance. For the employees' and teachers' systems (the two largest subsystems of SRPS), the State will maintain a constant employer contribution rate so long as those systems remain from 90 to 110 percent funded on an actuarial basis. For fiscal 2005 those systems will remain within their funding "corridors," and no increase in State pension contributions (beyond that reflecting payroll growth) will be required. The actuary advises that absent significant investment gains in fiscal 2004, the funding levels for the two major systems will "fall out" of their corridors next year, resulting in increased contribution rates for teachers and employees in fiscal 2006.

The rates for the other three State plans − judges, State Police, and law enforcement officers – continue to float each year according to the traditional methodology. Due to the high level of actuarial funding in the State Police Retirement System (121.0 percent funded), the State will not be required to make employer contributions for State Police in fiscal 2005. Employee contributions of 8.0 percent will continue in fiscal 2005.

Also, this year the actuary conducted its experience study of the system's actuarial assumptions, and the pension board voted to incorporate the recommended assumption changes into its valuation. While the actuary recommended a series of both positive and negative changes, the net effect of these changes was to improve the actuarial funding of the system. (The assumption study is required by statute and conducted every five years.)

Board and Agency Undergo Structural and Personnel Changes

The past year has marked significant structural and personnel changes for the pension board and the agency. The changes were precipitated by the board's failed computer procurement, its consistently poor investment performance, and the federal investigation of one of the board's investment managers.

In response, Chapter 403 of 2003 was enacted. Chapter 403 was sponsored by the Joint Committee on Pensions and increased the number of outside pension experts on the board and increased training requirements for board members. In addition, the board initiated its own governance study and is implementing the recommendations of its consultant. Finally, in the past year the board has replaced its executive director and chief investment officer.

The board's slightly improved investment performance results, progress in working with investment consultants in decision-making processes, and the agency's cautious approach to a successor project to the recently failed $37 million computer system procurement, show some marked improvement in the board's ability to fulfill its fiduciary and statutory duties.

For further information contact: Daniel P. Tompkins Phone: (410) 946/(301) 970-5510

Education

Implementation of Bridge to Excellence in Public Schools Act Continues: Important Policy Decisions Ahead

With the continued phase-in of the Bridge to Excellence in Public Schools Act, State education aid is scheduled to increase by $382 million in fiscal 2005 to $3.7 billion. In order for full funding of the Act to continue, however, the General Assembly must pass a joint resolution during the 2004 session affirming the State's ability to pay for the 11.5 percent increase. If the joint resolution is not passed, State aid increases will be scaled back considerably for fiscal 2005 through 2008.

Summary of State Aid to Education in Fiscal 2005

State education aid is estimated at $3.7 billion for fiscal 2005, a $382 million or 11.5 percent increase over fiscal 2004. Direct aid to local boards of education will total approximately $3.3 billion, and retirement payments will total $403 million. The increase in direct State aid is approximately 12.4 percent, compared to a 6.3 percent increase in 2004. Retirement costs paid by the State on behalf of local school systems are projected to increase by 5.1 percent in fiscal 2005, compared to an 8.2 percent increase in fiscal 2004.

The large fiscal 2005 increase in State education aid is due to the continued phase-in of the Bridge to Excellence in Public Schools Act of 2002 (Bridge to Excellence). As shown in **Exhibit 1**, formulae enacted or enhanced by the Bridge to Excellence Act account for 83.6 percent of State education aid and 93.8 percent of all direct aid to local boards of education in fiscal 2005. Increases in these programs, which will amount to an estimated $353 million, make up the majority of the total increase projected for State education aid.

Programs being phased out under the Bridge to Excellence Act will account for less than 2 percent of education aid in fiscal 2005. Baltimore City Partnership funding is scheduled to decrease by 25 percent, and the Governor's Teacher Salary Challenge Program also continues its phase-out, although the program is anticipated to increase in fiscal 2005 due to legislative reductions in the program in fiscal 2004. Both of these programs are scheduled to terminate prior to fiscal 2008.

Exhibit 1
Fiscal 2005 Estimated State Aid to Education
($ in Millions)

Program	**FY 2004**	**FY 2005**	**Change**	**% Change**	**% of FY 05**
Foundation Program	$2,013.4	$2,153.6	$140.2	7	58.2
Compensatory Education	350.8	476.4	125.6	35.8	12.9
Special Education Formula	116.3	155.6	39.3	33.9	4.2
Limited English Proficiency	38.9	54.3	15.4	39.7	1.5
Student Transportation	167	175.7	8.7	5.2	4.8
Guaranteed Tax Base	0	17.8	17.8	N/A	0.5
Teacher Salary Challenge	5.3	17.9	12.6	238.2	0.5
Baltimore City Partnership	28.2	21.1	-7.1	-25	0.6
Extended Elementary Education (EEEP)	19.3	19.3	0	0	0.5
Thornton Formulae Subtotal	**$2,739.1**	**$3,091.8**	**$352.7**	**12.9**	**83.6**
Retirement Payments	$383.60	$403.20	$19.60	5.1	10.9
Special Education – Non-Public Placements	104	115.2	11.2	10.8	3.1
Other	89.7	88	-1.7	-1.9	2.4
Total State Education Aid	**$3,316.3**	**$3,698.2**	**$381.9**	**11.5**	**100**

Source: Department of Legislative Services

New Elements of the Bridge to Excellence Set to Begin in Fiscal 2005

Two components of the Bridge to Excellence Act, the guaranteed tax base program and the Maryland-specific geographic cost of education index, will be implemented for the first time in fiscal 2005. The guaranteed tax base program provides additional funding to low-wealth counties based on local wealth and local education tax effort. Local jurisdictions with less than 80 percent of the statewide wealth per pupil will be eligible to receive additional State funding if they provide more local funding than is required under the foundation program. Estimated costs for the program are $17.8 million in fiscal 2005 and $86.2 million in fiscal 2008, when the program is scheduled for full implementation.

Fiscal 2005 will also be the first year that a Maryland-specific geographic cost of education index will be used to adjust the State share of the foundation program. In fiscal 2004, foundation program aid has been increased for four local school systems that have above average education costs according to a national geographic cost of education index that was developed several years ago for the National Center for Education Statistics. However, the Bridge to

Excellence Act required the Maryland State Department of Education (MSDE) to contract for development of a new Maryland-specific index that accounts for regional differences in the cost of education that are outside the control of local jurisdictions. MSDE contracted with the National Conference of State Legislatures to develop the index and provide recommendations for its implementation. The final index and recommendations will be presented in December 2003.

Dramatic Funding Increases Scheduled to Continue through Fiscal 2008 If the General Assembly Passes 2004 Joint Resolution

The phase-in of the Bridge to Excellence legislation is scheduled to continue through fiscal 2008 with increases in State education aid of approximately 10 percent annually. In total, aid for education is due to increase by an estimated 30.4 percent to $4.8 billion from fiscal 2005 to 2008. However, the Bridge to Excellence Act requires the General Assembly to review the State's fiscal condition in the 2004 session and decide if the new funding structure is affordable given the State's resources. In order to continue implementing the new funding formulae, the General Assembly must adopt a joint resolution by the fiftieth day of the 2004 session affirming the State's ability to pay for the enhanced funding in fiscal 2005. If the General Assembly does not pass the joint resolution, education funding will instead increase by approximately 5 percent per year through 2008. **Exhibit 2** compares estimated funding increases under full implementation and under the reduced aid model.

Exhibit 2

Estimated State Aid for Education Under Full and Reduced Models
Fiscal 2004 to 2008
($ in Millions)

	FY 2004	**FY 2005**	**FY 2006**	**FY 2007**	**FY 2008**	**Avg Ann % Incr**
Full Implementation	$3,316.3	$3,698.2	$4,048.3	$4,403.0	$4,822.3	9.8%
Reduced Model	3,316.3	3,482.5	3,659.7	3,842.7	4,032.9	5.0%
Difference	**$0.0**	**$215.7**	**$388.6**	**$560.3**	**$789.4**	

Source: Department of Legislative Services

Without the joint resolution, State aid in fiscal 2005 through 2008 would be derived from the fiscal 2004 framework. Funding for the various formulae would be based solely on a pre-determined increase over the prior year, rather than changes in enrollment, student populations, and wealth. Additionally, fiscal 2004 funding does not include the guaranteed tax base program or adjustments based on the Maryland geographic cost of education index, two measures included in the State aid structure to address the adequacy and equity of education funding. The difference for each county in fiscal 2008 per pupil State aid under full implementation and under the reduced model is shown in **Exhibit 3**.

Exhibit 3
Estimated Differences Between the Full and Reduced Aid Models
Fiscal 2008 Aid Per Pupil

County	Full Funding	Reduced Funding	% of Full
Allegany	$8,423	$6,993	83.0
Anne Arundel	4,077	3,753	92.0
Baltimore City	10,535	9,173	87.1
Baltimore	5,018	4,274	85.2
Calvert	5,229	4,306	82.4
Caroline	8,153	6,953	85.3
Carroll	4,826	4,449	92.2
Cecil	5,879	5,083	86.5
Charles	5,493	4,627	84.2
Dorchester	6,922	6,215	89.8
Frederick	4,631	4,136	89.3
Garrett	5,880	5,804	98.7
Harford	5,139	4,761	92.7
Howard	4,026	3,507	87.1
Kent	5,019	4,843	96.5
Montgomery	3,835	2,890	75.4
Prince George's	7,627	5,686	74.5
Queen Anne's	4,165	3,778	90.7
St. Mary's	5,430	4,739	87.3
Somerset	9,343	7,014	75.1
Talbot	3,117	3,118	100.0
Washington	5,653	5,102	90.3
Wicomico	7,034	5,617	79.9
Worcester	3,124	3,027	96.9
Total	**$5,801**	**$4,851**	**83.6**

Source: Department of Legislative Services

The provision regarding the joint resolution addresses only the funding portion of the Bridge to Excellence Act. Failure to enact the joint resolution will not affect the requirement that counties establish full-day kindergarten programs for all students and pre-kindergarten programs for economically disadvantaged four-year-olds.

Other Thornton Mandated Activities Concluding in 2003

The Bridge to Excellence Act required each local school system to submit a five-year comprehensive plan outlining the system's specific strategies for improving student achievement, eliminating achievement gaps, and meeting State and local performance standards. School systems must update their master plans each year to reflect success or failure in meeting stated goals.

MSDE provided significant technical assistance and guidance to local school systems throughout the development of these plans. All systems submitted their comprehensive master plans at the beginning of October 2003, and peer review teams are now assessing them. These review teams will make recommendations to the State superintendent regarding the completeness and content of the plans. The State superintendent must approve all master plans and may require a school system to make specific revisions if the superintendent determines that its plan as submitted will not improve student achievement.

The Bridge to Excellence Act also created two special entities to further study policy issues raised by the Act. The Task Force to Study Public School Facilities was established and charged with reviewing the ability of the State's school facilities to support the educational programs necessary for an adequate education as envisioned by the Thornton Commission. This task force will present its final findings and recommendations by January 2004. A separate issue paper discusses the activities and progress of this task force in greater detail.

The Act also required MSDE to convene a committee of stakeholders to examine issues related to the enrollment counts on which the Bridge to Excellence financing structure is heavily based. This year the committee has been studying the impacts of the new financing mechanism on systems with increasing and decreasing enrollments. The committee is considering several options to address the problems facing systems with increasing and decreasing enrollments and will make its final recommendation in December 2003. Current State aid estimates do not include any measures to compensate districts with increasing or decreasing enrollments, so any such policies would require additional funding.

For information contact: Kirsten B. Fairall/Mark W. Collins Phone: (410)946/(301) 970-5530

Education

Implementing the Federal No Child Left Behind Act in Maryland: Will Maryland's Bridge to Excellence Act Provide a Passage to Success?

In 2002, the federal No Child Left Behind Act and Maryland's Bridge to Excellence in Public Schools Act were signed into law with the common goal of improving educational achievement for all students. As Maryland begins its implementation of new federal requirements, the funding provided by the Bridge to Excellence Act has become more critical.

Federal and State Legislation Form a Common Objective

When President George W. Bush signed the No Child Left Behind Act (NCLB) into law in January 2002, federal involvement in education policy expanded significantly. The sweeping federal legislation requires highly qualified teachers to be employed for every classroom, yearly testing for students in grades three through eight, annual progression towards proficiency for all student populations, rigorous reporting requirements, and specific actions when schools and school systems are unable to improve student performance. NCLB was enacted with the hope of reducing and eventually eliminating achievement gaps through systematic examination of student outcome data within subgroups of students who have traditionally performed below average.

With an established statewide system of student assessments and a nationally-recognized accountability structure in place, Maryland had a head start on most states as it began implementing NCLB. To further aid the State as it faced the challenge of meeting new federal requirements, Maryland enacted the Bridge to Excellence in Public Schools Act four months after NCLB was signed. Although it was developed independently of NCLB, the Bridge to Excellence Act was founded on the same principles as the federal legislation. The Bridge to Excellence legislation overhauled and enhanced the State's education finance system and required school systems to articulate specific strategies that would be used to improve the educational attainment of all student populations. The State legislation was not introduced or passed with the goal of financing the new federal mandates, but the enhancements in State aid that will be provided under the Bridge to Excellence Act, estimated at more than $1 billion annually by fiscal 2008, have assumed greater relevance and importance because of NCLB.

No Child Left Behind Mandates

The mandates of NCLB can be placed into two categories, those that apply to all schools and those that apply to Title I schools that are failing to improve student performance. Title I schools generally enroll larger populations of impoverished students and, because of this, receive federal compensatory aid funding. The schools are subject to stricter federal oversight because they rely more on federal funds. Some of the mandates have immediate deadlines and consequences, while others, such as 100 percent proficiency for all students by 2014, establish long-term objectives.

Mandates that Apply to All Schools

There are two primary NCLB requirements that all schools must meet, annual student assessments and employment of highly qualified teachers for every class. Of these, annual testing is the more critical mandate because it acts as the accountability mechanism within the federal legislation. Title I schools that do not make adequate yearly progress (AYP) towards 100 percent student proficiency by 2014 are subject to further federal mandates designed to ensure better educational experiences for students. A full discussion of the State's implementation of new Maryland State Assessments, which enable the State to meet this mandate, can be found in the issue paper entitled "Implementation of the Accountability Mandates of the Federal No Child Left Behind Act." NCLB also contains specific reporting requirements for the State and local school systems, most of which surround student achievement and AYP.

Highly Qualified Teachers and Paraprofessionals

Possibly the most difficult NCLB mandate facing Maryland is the requirement that classroom teachers and paraprofessionals be "highly qualified." Beginning last school year, all teachers hired to work in Title I schools have been required to meet the highly qualified definition in NCLB. By the 2005 – 2006 school year, just two years from now, teachers in all schools must be highly qualified. To meet this standard, a teacher must hold a license to teach in the State and must have obtained full State certification or passed the State teacher licensing examination. Even more significant is the requirement that teachers have expertise in the subjects they are assigned to teach. Teachers who have had certification requirements waived on an emergency, temporary, or provisional basis also do not meet the highly qualified standard. A paraprofessional (teacher's aide) hired after January 8, 2002, who works in a Title I school must have completed two years of collegiate study, obtained an associate's degree or higher, or met a rigorous standard of quality in reading, writing, and mathematics. Aides who were hired before January 8, 2002, must meet these requirements within four years. As an indication of the difficulty Maryland could have in meeting this mandate, provisionally certified staff made up 10 percent of professional school staff in October 2002, including 29 percent of professional staff in Baltimore City schools and 19 percent of professional staff in Prince George's County schools. The NCLB standard goes beyond professional certification, meaning provisionally certified teachers are only a fraction of the teachers who are not highly qualified. Beginning with the current school year, the Maryland State Department of Education will report the percentage of classes that are being taught by highly qualified teachers. In addition to addressing teacher certification, the report will indicate the number of instructors in core academic areas who do not have subject matter expertise.

NCLB provides an alternative for veteran teachers to become highly qualified without requiring passage of a State licensing exam. On October 28, 2003, the State Board of Education adopted an option to achieve the NCLB teacher standard through a highly objective uniform state standard of evaluation (HOUSSE). HOUSSE is designed to provide veteran teachers multiple ways to demonstrate competency in the core academic areas they teach. Teachers who have not achieved certification from the National Board for Professional Teaching Standards in early childhood or elementary education and who do not have an advanced professional certificate must demonstrate competency through some combination of years of satisfactory teaching experience, continuous professional development, awards and publications, experience teaching in higher education settings, and experience serving in professional development organizations. To meet the teacher quality mandates in NCLB, Maryland will have to use the HOUSSE option in conjunction with other State and local teacher retention and recruitment initiatives.

Reporting Requirements

Because accountability is central to NCLB, strict reporting procedures are required to track school progress. The Maryland State Department of Education (MSDE) began annual reporting of State school systems and school data in 1991. Beginning with the 2003 Performance Report, NCLB requires Maryland to provide an annual report card with an expanded range of information, including statewide student achievement data broken down by race and ethnicity, socioeconomic level, disability, and English language proficiency. The annual report card must also include (1) information that can be used to compare actual achievement levels of each student subgroup to State performance objectives; (2) qualifications and credentials of teachers (in the aggregate and disaggregated for high-poverty and low-poverty schools); (3) two-year trend data regarding achievement by subject matter and grade level; (4) graduation and attendance rates; and (5) the number and names of schools identified as low-performing and designated for school improvement. In addition, local school systems are required to modify their own annual report cards to provide similar information on a school-by-school basis.

Mandates that Apply to Schools that Have Failed to Achieve Standards

Many of the requirements of NCLB only apply to Title I schools that consistently fail to make AYP. Federally-mandated remedies begin when a Title I school fails to make AYP for two consecutive years. At that time, the school is identified for school improvement and must offer students school choice the following year. If the school does not make AYP the following year, it must provide supplemental services at students' request. If AYP has not been met after two years under school improvement, a school is identified for more severe corrective action. A school that fails to make AYP for five consecutive years must develop a school restructuring plan, and the plan must be implemented after six years of not meeting AYP. In Maryland, the corrective action and school restructuring mandates apply to all public schools.

School Choice

During the first year a Title I school is identified for school improvement, NCLB requires the school to give students the option of transferring to a higher performing school in the same school district. A school system is responsible for the cost of transporting students who choose to transfer to different schools and may use up to 10 percent of its Title I funding to pay the additional transportation costs. In the first two years under this requirement, only a small percentage of eligible Maryland students have opted to change schools. In the 2002 – 2003 school year, 105 low-performing schools in 12 of Maryland's 24 school districts were required to offer transfer options to 59,312 students. However, transfers were only requested for 1,478 students (2.5 percent of eligible students) and only 709 students (1.2 percent) actually transferred to different schools. Most jurisdictions were able to accommodate all or almost all of the students who requested transfers, but Baltimore City and Prince George's County were unable to approve transfers for more than half of the students who requested them. The Maryland State Department of Education is working closely with these school systems to ensure that families requesting transfers will be accommodated in the current school year. In the current school year, students at 131 schools must be offered school choice.

Supplemental Educational Services

After three years of failing to meet AYP, a Title I school must offer supplemental educational services to Title I students. Supplemental services include tutoring, remediation, and other academic interventions. The services must be provided outside of the regular school day and must use research-based methods designed to increase student achievement. As with the student transfer option, a school system may use up to 10 percent of its Title I funds to pay for supplemental services. To date, MSDE has approved 15 supplemental educational services providers for local school systems to choose from. Parents of students who are eligible to receive supplemental services must be notified at least annually about the availability of services. In the 2002 – 2003 school year, 54 schools in four school districts were required to offer supplemental services to 29,838 eligible students. In the current school year, 109 schools in 11 school districts must provide this option.

Corrective Action and School Restructuring

Two years after being identified for school improvement, a Title I school that has not successfully met AYP must take corrective action. Corrective action may include replacing school staff responsible for the failure to meet AYP, implementing a new curriculum, or appointing outside experts to advise the school. If a school in corrective action fails to meet AYP, it must develop a restructuring plan the following year. The plan may involve closing the existing school and reopening it as a public charter school, replacing all or most school personnel, or State takeover of school operations. If AYP is not met again, the restructuring plan must be implemented. In the 2003 – 2004 school year, 19 schools in four districts have been identified for corrective action, and 64 schools in Baltimore City and Prince George's County have been placed in the restructuring category.

The Cost of Implementing No Child Left Behind

According to information provided by the U.S. Department of Education, in the year that the Elementary and Secondary Education Act (ESEA) was reauthorized under the NCLB moniker (federal fiscal 2002), Maryland received a $55.6 million (27 percent) increase in ESEA funding. This included an increase of $39.2 million (29 percent) in Title I funding, the largest component of ESEA. However, Maryland received a comparable increase in ESEA funding (25 percent) the year before NCLB was enacted, calling into question the true value of the NCLB funding increase. If Maryland does not meet the requirements of NCLB, federal ESEA funds, which total $267.2 million in federal fiscal 2003, could be withheld. Historically, federal aid has accounted for approximately five percent of primary and secondary education revenues in Maryland. This percentage has not varied significantly in at least 20 years.

Although there is wide consensus in the education community that implementing NCLB involves a financial commitment well beyond the additional federal funds that were provided when the legislation was enacted, isolating the costs of NCLB has been difficult. This may be due in part to repeated attempts to identify the costs of specific NCLB mandates. For example, the high costs associated with attracting and retaining highly qualified teachers have been cited frequently. However, the State and most school systems had strategies and initiatives aimed at teacher recruitment and retention before NCLB was enacted. It is problematic, therefore, to separate the costs of new strategies from the costs of practices that would have begun or continued even without NCLB.

Instead of focusing on costs of individual mandates, a different approach would examine NCLB costs more holistically. The core mandate in NCLB is that all students meet State performance standards. Through the work of the Commission on Education Finance, Equity, and Excellence (Thornton Commission), Maryland has already attempted to identify the costs of improving instruction to the point where every child can be expected to meet standards. Through careful analysis of two empirical studies examining educational costs, the Thornton Commission estimated an "adequate" level of funding that represents the cost of resources that would be needed to reasonably expect that students can meet the State's academic standards. New State aid formulas based on the Thornton Commission's definition of adequate funding and enacted by the Bridge to Excellence legislation are scheduled for phase-in over the next four fiscal years. (See the issue paper entitled "Implementation of Bridge to Excellence in Public Schools Act Continues: Important Policy Decisions Ahead.") As discussed above, many of the NCLB mandates only apply to schools that have continually failed to make AYP. If the infusion of new funding and educational resources successfully increases student achievement and enables local school systems to meet AYP goals, Maryland will have addressed many of the costs associated with NCLB mandates. If a combination of federal, State, and local funds do not reach an adequate level, then it is unlikely that Maryland will meet the mandates of NCLB or the goal of leaving no child behind.

For further information contact: Daneen M. Banks/Mark C. Collins Phone: (410) 946/(301) 970-5350

Education

Implementing the Accountability Mandates of No Child Left Behind

The Maryland State Department of Education is implementing the accountability mandates of the No Child Left Behind (NCLB) Act, part of a comprehensive accountability system in Maryland. The first results of the Maryland School Assessments, which replaced the Maryland School Performance Assessment Program in 2003, show the challenge Maryland faces for all student subgroups to achieve the NCLB requirements of Adequate Yearly Progress and 100 percent of students being proficient by 2014.

Within the past year, the Maryland State Department of Education (MSDE) has made great strides in laying the groundwork for full compliance with the accountability mandates of the federal No Child Left Behind Act (NCLB). Rigorous standards have been established for the incremental attainment of Adequate Yearly Progress (AYP) targets with the ultimate goal of 100 percent of all students being proficient by the 2013 – 2014 school year, as mandated by NCLB. Although the United States Department of Education (USDE) has established guidelines for the implementation of NCLB, many aspects of states' implementation plans have been subject to negotiation between a state and USDE. MSDE has merged Maryland's existing accountability system with the new federal requirements so that Maryland will have one comprehensive school accountability system.

Setting the Standards for Accountability

In lieu of the former Maryland School Performance Assessment Program (MSPAP), MSDE has set the standards for a new test, the Maryland School Assessment (MSA), which will gauge the performance of individual students, schools, school systems, and the State. This test will be administered in grades 3 through 8 during the 2003 – 2004 school year, but scores for grades 4, 6, and 7 will not be counted toward AYP until the 2005 – 2006 school year (as required by NCLB).

The Maryland School Assessment

During July of 2003, approximately 300 educators, stakeholders, public officials, and testing experts participated in a multi-phased process to set standards that would determine basic, proficient, and advanced levels of achievement for students in grades 3, 5, and 8 in the State. The first phase consisted of a content review of questions from the 2002 through 2003 MSA by teachers, principals, and other educators who interact with students on a daily basis. These educators were asked to review and reach consensus regarding both a proficient and an advanced level of achievement for the appropriate-aged student through the use of the "Bookmarking Standard Setting Procedure."[1]

The standards went through three additional levels of review before the State Board adopted the standards at the July 2003 State Board meeting.

The results of the first administration of MSA in spring 2003 were considered in determining the standards for basic, proficient, and advanced achievement on the MSA for grades 3, 5, and 8. **Exhibit 1** shows the percentage of students that were proficient (proficient plus advanced) from the 2003 MSA once the standards were set. The highest percentage of proficient students was in grade 5 reading – 65.7 percent scored proficient or higher – meaning that 34.3 percent of students in grade 5 are not proficient in reading.

Exhibit 1
2003 MSA Percentage of Students Proficient or Higher

Grade	Reading	Mathematics
3	58.1%	65.1%
5	65.7%	55.0%
8	59.9%	39.7%

Source: Maryland State Department of Education

MSA will provide data, as required by NCLB, for eight subgroups: five racial/ethnic subgroups (African American, American Indian, Asian/Pacific Islander, Hispanic, and White); one subgroup for students with limited English proficiency; one subgroup for students in need of special education services; and one subgroup for students who receive free and reduced priced meals. **Exhibit 2** gives an example of the subgroup data for third grade reading on the 2002 through 2003 administration of MSA. The data shows that different subgroups perform higher and lower than the average for all students.

[1] The "Bookmarking Standard Setting Procedure" entails the placing of a "bookmark" at a point in the test after which the reviewer feels that the student should be either proficient or advanced. The results of all the reviewers are then displayed and discussed. Following discussion, bookmarking is repeated. Following the second bookmarking, display and discussion are repeated. Finally, the median is held to be the recommendation of the group of reviewers. MSDE reports that this procedure is used throughout the nation for the establishing of standards in both other states and commercially produced assessment programs.

Exhibit 2
2003 MSA Results for Third Grade Reading

	Basic	Proficient	Advanced
All Students	41.9%	49.5%	8.6%
African American	58.6%	39.1%	2.3%
American Indian	49.6%	44.7%	5.6%
Asian/Pacific Islander	24.8%	58.1%	17.2%
Hispanic	60.8%	35.8%	3.3%
White	27.8%	58.7%	13.5%
Limited English Proficiency	82.2%	17.2%	0.5%
Special Education	75.9%	22.3%	1.9%
Free and Reduced Priced Meals	63.1%	35.4%	1.6%

Source: Maryland State Department of Education

Increasing Accountability in the State

Using the disaggregated data obtained from MSA, Annual Measurable Outcomes or targets are used to determine whether a subgroup, school, school system, or the State meets the requirements of AYP.

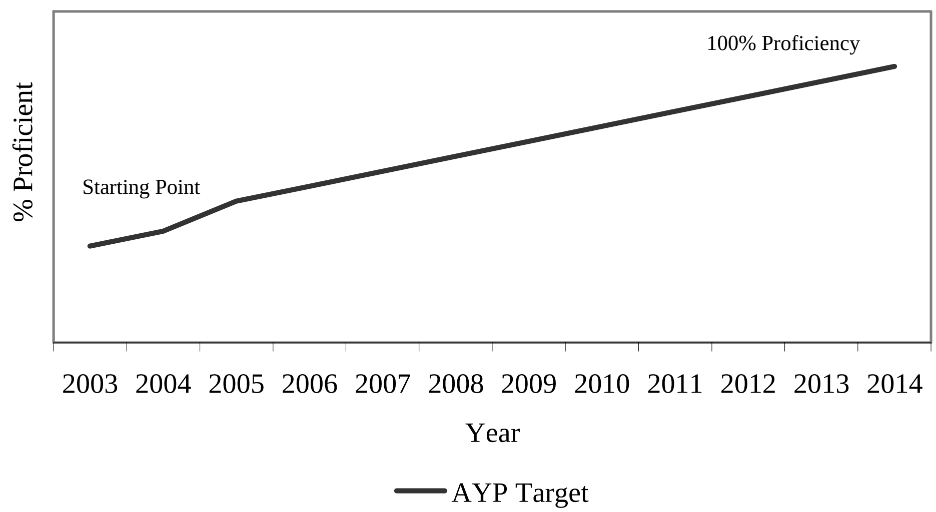
Adequate Yearly Progress

NCLB requires that all states have all students in all subgroups achieving at 100 percent proficiency by the 2013 – 2014 school year. To that end, NCLB requires specified intermediate targets in 2005, 2008, and 2011 in a linear progression from the starting point to the goal of 100 percent proficiency. States have adopted various approaches to meeting these intermediate targets according to the National Conference of State Legislatures (NCSL). Many states have taken a "back-loaded" approach (22 states), meaning smaller annual improvements in the first years and substantial annual improvements in the final years, while others have adopted a stair-step approach (13 states), meaning one year of improvement followed by several years of level performance, and other states a linear or incremental approach (9 states).

Exhibit 3 illustrates the approach being taken in Maryland. Maryland's approach is linear, with a slight stair-step in 2003 – 2004. MSDE has taken into consideration that during the first year of accountability, 2003 – 2004, a slight stair-step would be beneficial to allow schools and school systems to adjust their instructional strategies to the new standards and assessments. For the 2003 – 2004 school year, the AYP target will be one-third of the difference between the starting point and the 2004 – 2005 intermediate goal. The starting point is set at the percent of students scoring proficient at the school which accounts for 20 percent of the State's student population when grouped with all other schools with a lower percent proficient. After 2004 - 2005, the State will be on a linear track towards the goal of 100 percent proficiency. Although the ultimate goal of 100 percent proficiency is known, the starting points or targets vary for each grade and each subject tested. Therefore, the graph in Exhibit 3 is illustrative only.

Exhibit 3

Annual Targets 2003-2014



Source: Department of Legislative Services

Participation Rate

NCLB additionally requires that 95 percent of a subgroup participate in the assessment in order to meet AYP. MSDE reports that in order to keep the AYP focus on performance, MSDE has eliminated the possibility of failure due to an inability to meet the participation rate requirement. This is accomplished by assigning a score of "basic" to a student who does not take the test. Therefore, Maryland has a 100 percent participation rate.

Failing to Meet AYP and "Safe Harbor"

The most recent AYP assessment of the State indicates that 36 percent of schools (or 131 schools) failed to meet AYP. No school system in Maryland met AYP. The most common reasons for schools and school systems failing to meet AYP are the proficiency levels of special education and student populations. Based on this first year of data, it is the achievement of these three subgroups that poses the greatest difficulty to Maryland's compliance with NCLB. MSDE is particularly concerned that the inclusion of special education students in NCLB requirements is inappropriate and is in discussions with USDE (along with many other states) to alter this requirement. Although all schools met the attendance rate/graduation rate requirement, two school systems did not (Baltimore City did not meet attendance or graduation, Charles County did not meet attendance).[2]

However, a failing school or school system may avoid the corrective action that results after continued failure to meet AYP if it manages to meet the requirements of the Safe Harbor provision of NCLB. Safe Harbor provides that if a subgroup that would otherwise fail to meet AYP decreases the percentage of students performing below proficient by 10 percent from the previous year, then the school may avoid correction action initiatives. Current data does not reflect how many schools in the State will be protected by the Safe Harbor provision because only one year of AYP has been measured thus far. At the end of the 2003 – 2004 school year, that data will be available.

Regulations relating to the Safe Harbor provision of NCLB are still being refined. Although a school that falls within Safe Harbor receives a pass on corrective action, it is a temporary pass because a school may only stay there for one year. At the end of that year, the school has an even greater challenge in meeting the rising AYP target.

[2] The attendance rate target was set at 94 percent back in 1989, and MSDE will use this attendance rate target for purposes of AYP. By the 2013 – 2014 school year, in order to make AYP, subgroups, schools, school systems, and the State must achieve a graduation rate of 90 percent. General education diploma (GED) students are not included in this calculation.

Education

Task Force to Study Public School Facilities Continues Its Work

While funding for public school construction rose to a high of $288 million in 2001, funds for public school construction are expected to be approximately $100 million per year for the next four years. This occurs at a time when significant requirements for K-12 education will be imposed through the Bridge to Excellence in Public Schools Act of 2002 and the federal No Child Left Behind Act. The Task Force to Study Public School Facilities must grapple with these and other issues as it works toward issuing its final report.

Background

In 2002, the Bridge to Excellence in Public Schools Act (Chapter 288) established a Task Force to Study Public School Facilities. Chapter 288 directed the task force to look at whether the State's school facilities are adequate to sustain programs provided for under the Act and supported by proposed funding levels. The Act further directed the task force to examine the equity of the State's school construction program, particularly the equity of the State and local cost shares for school construction projects; whether to continue the Aging School Program as a permanent program; and any other issues the task force determines are relevant to evaluate the adequacy and equity of the State's school construction program.

Faced with the difficult tasks of defining adequacy and seeking equity in school construction in a time of budget deficits, the task force submitted a preliminary report in December and requested an extension of its mandate into 2003. The General Assembly agreed, extending the task force until May 1, 2004.

Issues Facing the Task Force

The task force began meeting again in September 2003. At that time the task force received information that although public school construction funding had been as high as $288 million in 2001, the 2005 through 2008 Capital Improvement Program anticipates only $100 million annually in the Public School Construction Program (PSCP). These funding levels do not appear to be sufficient given the backlog of public school construction projects. An estimated $273 million will be needed for projects that have already been approved for planning by the Inter-Agency Committee on School Construction.

Moreover, the public school construction needs of local jurisdictions may be under additional pressure as a result of the requirements of the Bridge to Excellence in Public Schools Act and the federal No Child Left Behind Act, particularly related to the State mandate for full-day kindergarten for all students by the 2007 to 2008 school year. Another issue the task force must address is renovation and renewal of existing schools at a time when significant funding is required for new construction. Consideration of all of these issues are further complicated by the severe fiscal condition facing both the State and local governments.

Work of the Task Force toward a Final Report

In completing its charge, the task force undertook an assessment of the current conditions of the State's existing public schools. A survey was conducted by the PSCP based on 31 minimum facility standards developed by a workgroup chaired by Dr. Nancy Grasmick and approved by the task force in March 2003. The standards were based on local, State, and federal standards for facilities and included the ability of the facility to support educational programs. The National Clearinghouse for Educational Standards reports that Maryland's survey is the first of its kind in the nation. The survey results were released on November 6. More than one-third of public schools across the State did not meet the standard in at least one of eight facility areas. Among the facility areas in need of attention are student capacity, accessibility for students with disabilities, existing pre-kindergarten and kindergarten classrooms, and spaces for secondary science, fine arts, and health services. It should be noted that many of the standards are based on relatively new standards developed in the last 10 to 15 years. Only 26 percent of Maryland's school space has been constructed or undergone major renovation since 1990. All schools are required to meet the current standards when they are constructed or renovated. The estimated cost to correct all deficiencies identified by the survey in each jurisdiction will be released to the task force in early December.

The task force also established a workgroup to consider alternative funding mechanisms that will consider proposals such as impact fees, excise taxes, lease-leaseback arrangements, and public-private partnerships. Other issues that have been or will be considered by the task force include major facility issues facing school systems; review of projected enrollments; review of the State funding allocation process; review of funding requests and categories of facilities needs; additional needs related to implementation of full day kindergarten and pre-kindergarten; local ability to match State funds; options for modifying State and local shared cost formulas; incentives for schools with high proportions of disadvantaged students and for schools in economically distressed (One Maryland) counties; and allocation options for the Aging School Program. The task force is scheduled to issue a final report in January 2004.

For further information contact: Rachel H. Hise/Victoria L. Gruber Phone: (410) 946/(301) 970-5510

Higher Education

Enrollment and Tuition and Fees Rise as State Funding Falls for Public Higher Education

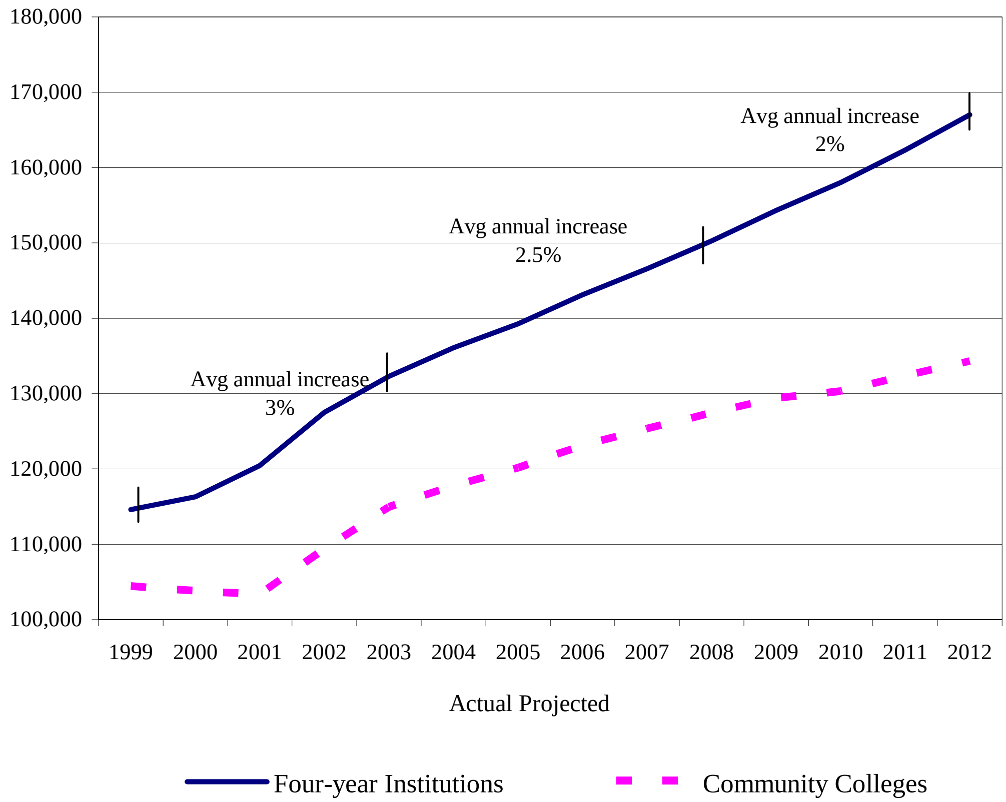
If State funding is frozen in fiscal 2005, State funds per full-time student at public four-year and community colleges will decline if enrollment grows as projected. However, at public four-year campuses, total revenues per full-time student will continue to increase because non-State revenues, mainly tuition and fees, have risen fast enough to offset enrollment growth and loss of State funds.

Enrollment Growth Projections Increase, but Next Few Years Slightly Slower Than Previous Few Years

According to current projections from the Maryland Higher Education Commission (MHEC), total headcount enrollment at Maryland public colleges and universities is projected to increase by 24 percent, or over 59,000 students by fiscal 2012, as shown in **Exhibit 1**. From fiscal 1999 through 2003, the average annual increase was 3 percent. For fiscal 2004 through 2009, MHEC is predicting an average annual increase of 2.5 percent. This reflects a 4,000 student increase above last year's 10-year projections and includes a more optimistic view of growth expected at community colleges. State-funded full-time enrollments at community colleges are now projected to increase 36 percent over the next nine years – 2,000 more students than predicted by MHEC last year. At public four-year campuses, part-time undergraduate enrollments make up 62 percent of the total anticipated additional students. This number is largely fueled by tremendous growth in on-line enrollments at the University of Maryland University College (UMUC).

The growth for most public four-year institutions is in line with past growth, with the exceptions of Bowie State University and UMUC, both of which are growing more than originally anticipated. The large majority of institutions are expecting growth between 1 and 3 percent, while the University of Maryland, Baltimore and St. Mary's College of Maryland (SMCM) are expecting less than 1 percent growth.

Exhibit 1
Head Count Enrollment
Projected through Fiscal 2012

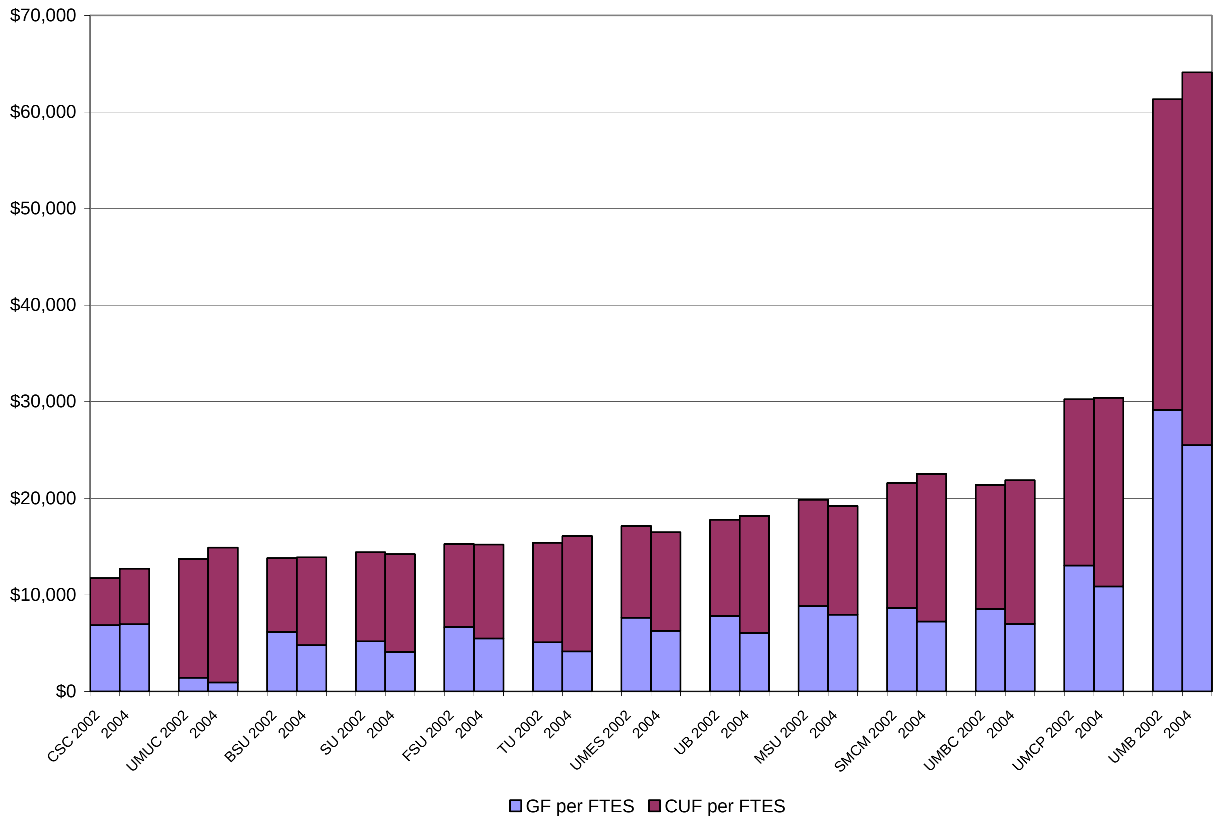


Source: Maryland Higher Education Commission

Public Colleges and Universities Increase Total Revenues Despite Declining State Support

Due to recent reductions to State funding for higher education, the University System of Maryland is considering curbing enrollment growth, claiming that its institutions are strapped for resources and must reduce programs and services. **Exhibit 2** compares State funding and current unrestricted funds per full-time equivalent student (FTES) at USM institutions, Morgan State University (MSU), and SMCM in fiscal 2002 and 2004 after cost containment. The average decrease in general funds per FTES from fiscal 2002 to 2004 is 16 percent, or $1,478.

Exhibit 2
General Funds and Current Unrestricted Funds per FTES
Fiscal 2002 and 2004
($ in Millions)



Note: CSC – Coppin State College
UMUC – University of Maryland University College
BSU – Bowie State University
SU – Salisbury University
FSU – Frostburg State University
TU – Towson University
UMES – University of Maryland Eastern Shore
UB – University of Baltimore
MSU – Morgan State University
SMCM – St. Mary's College of Maryland
UMBC – University of Maryland Baltimore County
UMCP – University of Maryland, College Park
UMB – University of Maryland, Baltimore

Source: Governor's Budget Books, Fiscal 2004; Department of Legislative Services; University System of Maryland, Morgan State University, and St. Mary's College fiscal 2004 budget requests

Despite the drop in State funding per FTES in recent years, total current unrestricted funds (CUF), the sum of most major operating revenues, has actually increased overall from fiscal 2002 to 2004. Despite large decreases in general funds and some substantial increases in enrollment, CUF remained the same or increased at a majority of the institutions. The only exceptions are at Salisbury University, University of Maryland Eastern Shore (UMES), and MSU. The average increase in CUF per FTES from fiscal 2002 to 2004 is 2 percent, or $441. Current unrestricted funds have increased largely because of the increases in tuition and fee rates to offset general fund decreases at USM institutions.

Tuition and Fee Increases Offset Reduced General Funds

From fall 2002 to 2003, average tuition and fee rates at USM institutions have increased an average of 18 percent. The USM budget as proposed in fall 2002 assumed an initial 4 percent increase. After cost containment reductions in winter of 2003, USM adopted a 5 percent mid-year tuition increase to help offset reduced general fund support in fiscal 2003. At the beginning of fiscal 2004, in response to the outcome of the legislative session and the Board of Public Works actions, USM raised tuition rates another 10 percent.

The combined actions of the General Assembly and the Board of Public Works reduced the USM budget $67 million in fiscal 2003 and $54.7 million in fiscal 2004. However, the large tuition and fee rate increases brought in $85 million in additional revenues, offsetting 70 percent of the reduced general funds, allowing the institutions' CUF to grow in spite of general fund reductions. **Exhibit 3** shows tuition and fee rates from fall 2003 to 2005 estimates.

Coppin did not implement the mid-year tuition increase because their students' ability to pay is already very low. UMUC, MSU, and SMCM also did not implement a mid-year increase.

The current fall 2004 (fiscal 2005) estimates include $72.5 million in new tuition and fee revenue, a 10 percent increase over the working fiscal 2004 revenue. At Coppin State, tuition and fee rates for full-time in-state students increased the least amount, 5.1 percent, while at the University of Maryland, College Park the increase is 9.9 percent. The average increase for full-time nonresidents is 7.5 percent. However, USM has included $61 million for enhancements in their fiscal 2005 budget request and maintains that should this list of enhancements not be funded by the State, the Board of Regents will have no choice but to raise tuition and fee rates again during the 2003 to 2004 academic year.

Funding Guideline Progress Reversed

On October 30, 2003, MHEC approved fiscal 2005 funding guidelines for USM institutions and MSU. (Funding for St. Mary's College is based on an inflationary formula, not a guideline.) Guidelines aim to represent an appropriate level of general fund support, defined as the seventy-fifth percentile of per student expenditures among current peer institutions, accounting for varying tuition rates at different institutions. As shown in **Exhibit 4**, MHEC approved guidelines totaling over $1.23 billion and recommended an appropriation of $879 million. In fiscal 2004, the guideline was reduced to $1.17 billion with the current appropriation after cost containment at $808 million.

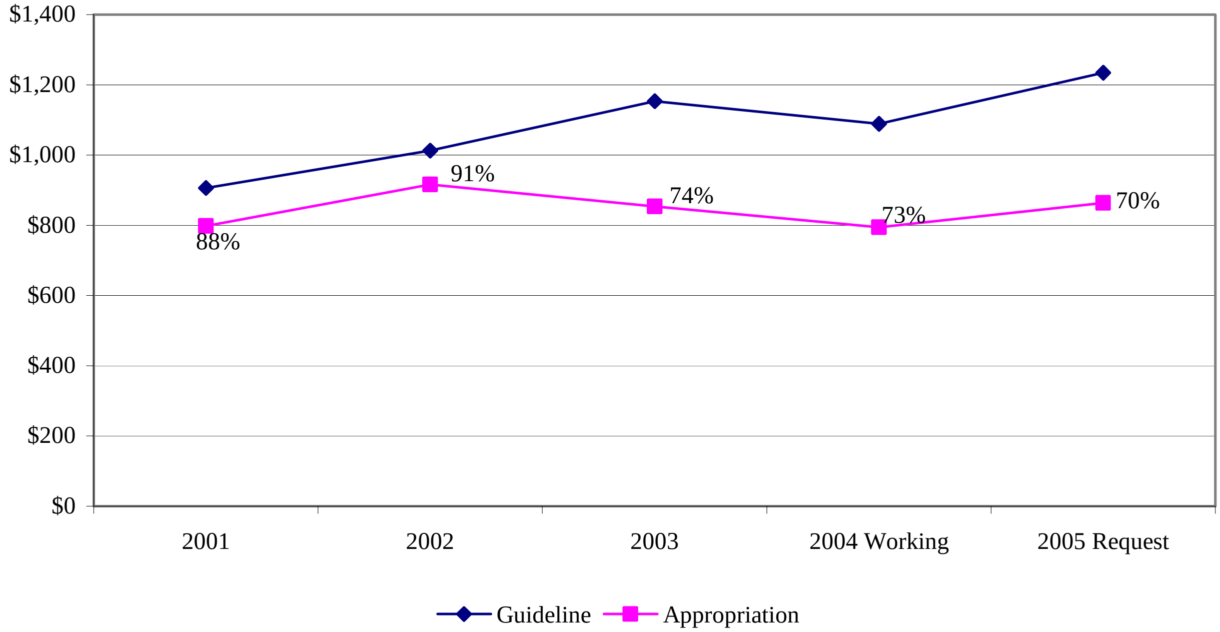
Exhibit 3

Tuition and Fees at USM, Morgan, and St. Mary's

		FY 2003 Final	FY 2004 Original	FY 2004 Working	FY 2005 Proposed	% Change 2003 - 2004	% Change 2004 - 2005
UM College Park	Resident	5,670	5,947	6,759	7,426	19.2%	9.9%
	Non-resident	14,434	15,189	17,433	18,726	20.8%	7.4%
Bowie State	Resident	4,064	4,398	4,853	5,218	19.4%	7.5%
	Non-resident	10,480	11,071	12,465	13,583	18.9%	9.0%
Towson	Resident	5,401	5,654	6,226	6,672	15.3%	7.2%
	Non-resident	12,753	13,300	14,298	15,352	12.1%	7.4%
UM Eastern Shore	Resident	4,461	4,692	5,105	5,558	14.4%	8.9%
	Non-resident	8,999	9,563	10,440	11,421	16.0%	9.4%
Frostburg State	Resident	4,618	4,804	5,342	5,830	15.7%	9.1%
	Non-resident	10,424	10,842	12,242	13,374	17.4%	9.2%
Coppin State	Resident	3,959	4,060	4,240	4,454	7.1%	5.0%
	Non-resident	9,368	9,549	10,062	10,626	7.4%	5.6%
U of Baltimore	Resident	4,996	5,344	5,913	6,448	18.4%	9.0%
	Non-resident	13,766	14,464	16,319	17,791	18.5%	9.0%
Salisbury	Resident	4,804	4,960	5,564	5,976	15.8%	7.4%
	Non-resident	10,568	10,954	12,452	13,554	17.8%	8.8%
UM Baltimore County	Resident	6,362	6,616	7,388	8,020	16.1%	8.6%
	Non-resident	12,546	13,048	14,290	15,620	13.9%	9.3%
St. Mary's College	Resident	8,145	8,742	7,550	7,928	-7.3%	5.0%
	Non-resident	13,417	14,387	13,870	14,564	3.4%	5.0%
Morgan State	Resident	4,698	4,972	5,078	5,578	8.1%	9.8%
	Non-resident	11,118	11,742	12,076	12,748	8.6%	5.6%
Average Statewide Tuition and Mandatory Fees (not weighted)							
Resident		5,198	5,472	5,820	6,283	5.3%	8.0%
Non-resident		11,625	12,192	13,268	14,305	4.9%	7.8%

Source: University System of Maryland, Morgan State University, and St. Mary's College fiscal 2004 and 2005 budget requests

Exhibit 4
Funding Guideline and Appropriation
Fiscal 2001 – 2005
($ in Millions)



Source: Maryland Higher Education Commission

When the State first used guidelines for USM institutions in fiscal 2001, matching appropriations to the guidelines would have required dramatic increases in funding for public higher education institutions. Consequently, actual funding levels reflect a phase-in of the guideline amounts. USM institutions were funded at 88 percent of guideline in fiscal 2001. In fiscal 2002, MHEC adopted a guideline for MSU, and overall guideline attainment reached its high, 91 percent. In the past two years, guideline attainment has decreased due to lower appropriations as well as cost containment measures. Given institution requests, which MHEC is recommending, appropriations would be 70 percent of the guidelines in fiscal 2005. However, data for measuring funding guideline attainment has a one-year lag time; once final numbers are collected from the funding peers, fiscal 2004 actual attainment will be different.

Although the guideline attainment is 3 percent lower in fiscal 2005 than in fiscal 2004, actual funding has increased. Therefore, a drop in attainment does not equate to a drop in funding. Guideline attainment is influenced by factors outside of State funding, such as enrollment at the Maryland institution and its peer institutions, funding at an institutions' peers, and inflation assumptions used to calculate the guideline.

Community Colleges Receive Reduced State Support While Increasing Tuition and Fees Moderately

Fiscal 2004 Cost Containment Actions

The Board of Public Works cost containment in July 2003 reduced general fund support for community colleges by $9.7 million to a total of $151.1 million. Of the reduction, $9.6 million came from the John A. Cade formula (Cade formula) funding for community colleges, with the remainder from the English for Speakers of Other Languages (ESOL) grants. The Cade formula action represented a 6.3 percent total reduction in that program and was applied to each jurisdiction's aid. This reduction brought per pupil formula funding to $1,860, approximately an 11.4 percent decrease from the fiscal 2003 level of $2,099.

Fiscal 2005 State Aid to Community Colleges

Funding for community colleges through the Cade formula is expected to be level in fiscal 2005 at a total of $142.7 million. Given an estimated 1.5 percent increase in enrollment for the 2002 through 2003 school year (the second prior year on which funding is based), this level of support represents per pupil funding of $1,832, or a corresponding 1.5 percent decrease from the fiscal 2004 level.

The Cade formula is based on a percentage of the per pupil general fund support for selected public four-year institutions in the prior fiscal year. Therefore, the community colleges will see the impact of the reductions made to those institutions in the 2003 legislative session and in fiscal 2004 cost containment in fiscal 2005.

Funding for other grant programs is expected to increase by $5.4 million to $13.8 million in fiscal 2005. This increase is due largely to programs that were either unfunded or not fully funded in 2004. For example, the Innovative Partnership for Technology program is expected to total $3.3 million in fiscal 2005, because obligations from fiscal 2004 were not funded.

Tuition and Fees Increase Moderately

For the fall semester of 2003, all but three of the community colleges have increased their tuition rates for students in their jurisdictions. Allegany Community College, the College of Southern Maryland, and Wor-Wic Community College did not increase tuition rates. Statewide, the average increase per credit hour is $5, bringing the average per credit hour rate to $78.

Additionally, a few colleges have increased their fees. Overall, average total annual costs for a full-time student (taking 30 credit hours over two semesters) are estimated to total $2,675, a $147 or 5.5 percent increase over the 2002 through 2003 school year. Six community colleges estimate total annual costs will increase by over $200 (Harford, Hagerstown, Frederick, Prince George's, Baltimore County, and Montgomery), five will increase over $100 (Baltimore City, Cecil, Chesapeake, Anne Arundel, and Howard), and five estimate either no increase or an increase of less than $100 (Carroll, Garrett, College of Southern Maryland, Wor-Wic, and Allegany).

For further information contact: Jessica E. Jordan Phone: (410) 946/(301) 970-5530

Higher Education

Financial Aid Funding Lags Behind As Tuition Rates Increase

The Governor flat-funded State student financial aid for fiscal 2004, and funding was reduced 4.5 percent by the July Board of Public Works cost containment action. Over 5,400 students are currently on the waiting list for need-based aid for fiscal 2004, as State financial aid is not keeping pace with large tuition rate increases – 45 percent since fiscal 2000. Aid provided by institutions helps offset the increasing burden on students though the average amount that is need-based remains low. Fiscal 2004 is the first year for the new campus-based educational access grant program that aims to decentralize the awarding process for a portion of need-based aid.

Financial Aid Funding Decreases for Second Year

State appropriations for scholarship programs administered by the Office of Student Financial Assistance (OSFA) at the Maryland Higher Education Commission (MHEC) decreased 1.5 percent from fiscal 2003. The fiscal 2004 appropriation totaled $80.3 million compared to $80.7 million in fiscal 2003. HOPE scholarships continue to make up a large portion (24 percent) of the total financial aid budget, second to need-based aid, which increased 1.8 percent, due to budget bill language requiring $765,624 from HOPE be transferred into need-based aid. Without this transfer, need-based aid would have decreased by 1 percent in the current fiscal year.

The July 30, 2003, Board of Public Works actions reduced the total financial aid appropriation by $3.6 million, or 4.5 percent. Following the cost containment actions, tuition and fee rates were increased an average of 13.5 percent, making the total tuition and fee increase from fall 2002 to fall 2003 average 18 percent. **Exhibit 1** compares the percent increases in need-based aid to the percent increases in tuition and fee rates. As shown, need-based aid has remained relatively constant for three years, despite large increases in tuition and fee rates. **Exhibit 2** compares the average award amount for Educational Excellence Awards (EEA), the largest State-funded need-based aid program, and Guaranteed Access (GA) awards for the State's neediest students, in fiscal 2000 and 2004 estimates, as compared to mandatory full-time equivalent undergraduate tuition and fees at University of Maryland College Park. As shown, tuition and fees have increased 45 percent, and the average EEA is estimated to cover only 25 percent of the cost of tuition and fees in fiscal 2004.

Exhibit 1
Percent Increase of Average Tuition and Fees at USM Institutions Compared to Percent Increase in State Need-based Aid Fiscal 1994 – 2004

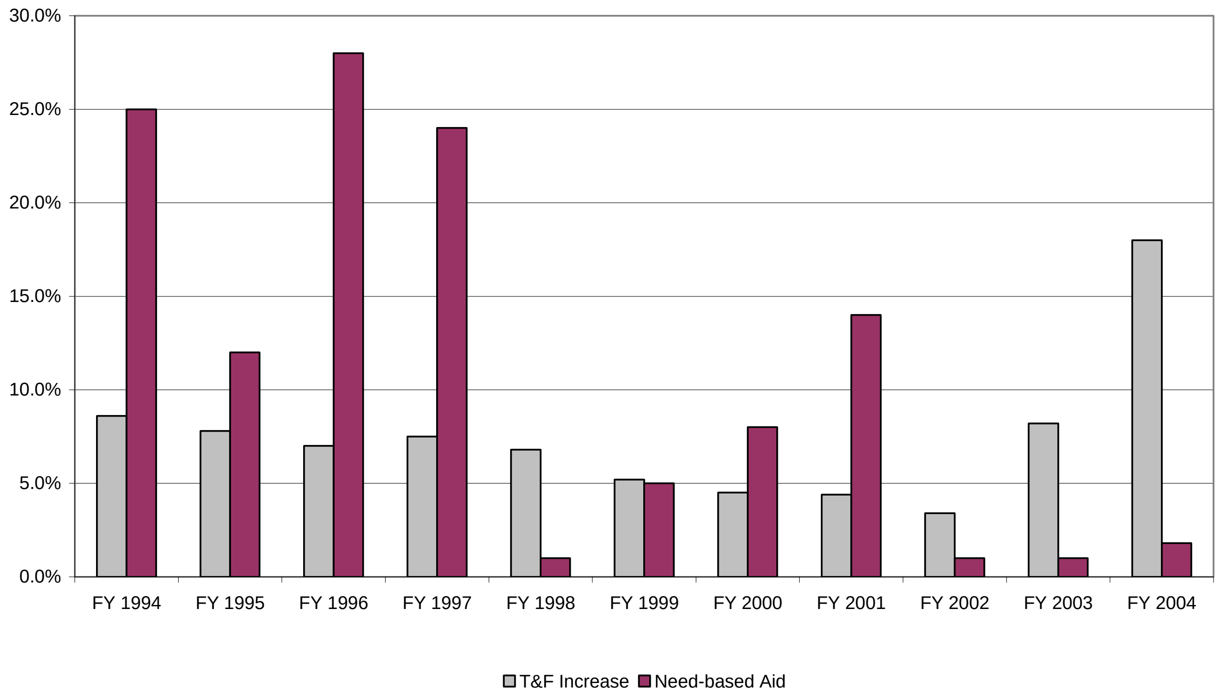


Exhibit 2
State Need-based Aid Compared to Tuition and Fees at UMCP
Fiscal 2000 and 2004

	Educational Excellence Awards		Guaranteed Access		
	Avg Award Amount	**Full Award Amount***	**Avg Award Amount**	**Full Award Amount**	**Tuition and Fees**
FY 2000	1,428	2,500	5,727	8,400	5,136
FY 2004**	1,694	2,700	7,169	11,600	7,426
% Increase (00-04)	**19%**	**8%**	**25%**	**38%**	**45%**

*The statutory maximum is $3,000; however, funding has not enabled MHEC to achieve this without awarding significantly fewer students.

**Fiscal 2004 average award amounts are estimates. These amounts will change as cancellations come in.

Source: Maryland Higher Education Commission

Since the financial aid appropriation is not keeping pace with tuition and fee increases, more students are on waiting lists for financial aid, and need-based aid covers a smaller percentage of the cost of attendance for its recipients. For academic year 2002-2003, nearly 3,600 students were eligible for need-based aid but did not receive it. Currently, there are waiting lists for several programs, especially need-based aid, for fall 2003 enrollment.

Exhibit 3 compares the final waiting list numbers from fiscal 2003 to those in fiscal 2004, as of October 2003. While the fiscal 2004 waiting lists will decrease slightly as students who have been awarded financial aid in the first awarding cycle turn down their awards, the growth in waiting lists is extensive. To the extent possible, the OSFA continues to award students from the waiting list as awards are turned down. It is also the practice of the OSFA to over-award based on known cancellation rates for the different scholarships. Currently, Educational Excellence Awards, the largest form of need-based State aid, is over-awarded by $8 million, yet there are still over 5,400 students on the waiting list.

Exhibit 3
Program Waiting Lists for 2003 and 2004 Academic Year

Program	2003	2004*
Educational Excellence Awards		
Educational Assistance Grant[1]	3,598	5,443
McAuliffe Memorial Teacher Scholarships	71	89
HOPE Scholarships		
HOPE Scholarship - General	276	688
HOPE Scholarship - Science and Technology	248	874
HOPE Scholarship - Maryland Teacher		983
HOPE Scholarship - Community College Transfer	37	164
Loan Assistance Repayment Program	147	
Nursing Scholarship	228	579
Developmental Disabilities	14	418
Conroy Memorial Scholarship		27
Child Care Providers		7

[1]Students that file the Free Application for Federal Student Aid after the March 1 deadline are not put in the system unless funds are available for late awards.

*As of October 1, 2003.

Availability of Institutional Aid Helps Alleviate Burden of Higher Tuition Rates

The State and federal need-based aid programs are not the only source of aid to students. Each institution provides several types of awards to its students including institutional grants, merit-based scholarships, and athletic scholarships; a student's need is often one of several factors determining awards. In fiscal 2002, USM institutions provided a total of $49.9 million in institutional aid, an increase of $7 million, or 16.5 percent, over what was provided in fiscal 2000. In fiscal 2002, $11.6 million (23 percent) of the total was for grants, $28.5 million (57 percent) was merit-based, and $5.8 million (11.6 percent) was for athletic scholarships. This leaves a remainder of 8.4 percent, or $3.87 million, that was used for nonspecified types of aid. The ratio of each of these categories to the total stays the same from fiscal 2000 to 2002.

New Decentralized Program for Need-based Aid Begins in Fiscal 2004

Fiscal 2004 is the first year for the Campus-Based Educational Assistance Grant (EAG) program. The Campus-Based EAG provides funds via MHEC to Maryland public and independent colleges and universities based on the number of Maryland, undergraduate, full-time students with demonstrated financial need enrolled in degree-granting programs. Each year the Secretary of Higher Education will determine an amount to be allocated from the Educational Excellence Awards Program unexpended at the end of the prior year up to $2.5 million, specifically to award Campus-Based Educational Assistance Grants.

Each institution's financial aid office is responsible for selecting recipients who meet all eligibility criteria. Eligibility criteria includes the following:

- be Maryland residents that file for federal need-based aid;
- have family income below 130 percent of the federal poverty level;
- begin college within one year of completing high school;
- be under the age of 22 at the time of the first award; and
- have a grade point average of at least 2.5 on a 4.0 scale or its equivalent.

Institutions use the allocated funds to award students who filed their federal aid form after the State's March 1 deadline. The award amounts may range from $400 to $2,700 based on the student's percent of need. Percent need is calculated using the cost of attendance minus the expected family contribution and other scholarships received. The allocations to the institutions are based on the estimated number of full-time Maryland Pell (federal need-based aid) recipients at each institution for the 2001–2002 academic year.

For further information contact: Jessica E. Jordan Phone: (410) 946/(301) 970-5530

Higher Education

In-state Tuition for Undocumented Immigrants and U.S. Military Personnel Legislation Vetoed by the Governor

In the 2003 session, the General Assembly passed House Bill 253 which would have allowed specific categories of undocumented immigrants, U.S. Armed Forces personnel and their dependents and spouses, and honorably discharged veterans to qualify for resident tuition rates at Maryland's public institutions of higher education. The Governor vetoed this legislation on policy grounds and the potential State cost, which is indeterminate.

Illegal Immigrant Population

In 2001, the U.S. Census Bureau estimated that there are 11 million undocumented immigrants living in the United States. The Census Bureau further estimated that about 50,000 to 65,000 undocumented or illegal immigrant students graduate from high school each year. Estimates of the undocumented immigrant population in Maryland vary. In February 2003, the U.S. Immigration and Naturalization Service estimated that about 56,000 undocumented immigrants live in the State.

Federal Law Regarding Education for Illegal Immigrants

In 1996, Congress passed the Illegal Immigration Reform and Immigrant Responsibility Act which prohibits states from "providing a postsecondary education benefit to an alien not lawfully present unless any citizen or national is eligible for the same benefit." Under current law, undocumented immigrants are ineligible for federal or state financial assistance for higher education.

In 2003, bipartisan legislation was introduced in the U.S. House of Representatives and U.S. Senate to address issues related to undocumented immigrants. The legislation repeals the 1996 restriction on state residency requirements for college tuition, permits qualifying undocumented immigrant students to apply for "green cards" as legal permanent residents, and allows states to offer minor immigrant students in-state tuition and student financial aid. As of November 2003, Congress has not acted on this legislation.

Immigrant Tuition Laws in Other States

Even with the federal ban on allowing in-state tuition rates to illegal immigrants, more than 20 states have considered legislation granting in-state tuition charges for undocumented immigrant students. Since 2001, California, Texas, New York, Utah, Oklahoma, Illinois, and Washington have enacted laws that get around the federal ban by basing in-state tuition on criteria other than residency (*e.g.*, students must go to and graduate from a high school in the state). Some states have considered legislation that would further restrict access to education benefits. In April 2003, Virginia Governor Mark Warner vetoed a bill that would have prohibited an undocumented immigrant from receiving any higher education benefits, including in-state tuition.

2003 Legislation

As passed by the General Assembly, House Bill 253 would have exempted undocumented immigrant students from paying the higher nonresident tuition charges at the State's community colleges and four-year public institutions of higher education. Once accepted into college, these students would have been allowed to pay the lower, in-state tuition rate, if the student:

- attended a high school in Maryland for at least three years;
- graduated from a Maryland high school or received the equivalent of a high school diploma (*e.g.*, a general education degree (GED)) in Maryland;
- registered as an entering student to attend the college no earlier than the fall 2003 semester;
- provided an affidavit stating that the individual would file for permanent U.S. residency within 30 days after becoming eligible to do so; and
- made an application to attend the college within five years of graduating from high school or receiving the GED.

The bill would also have prohibited a public institution of higher education from awarding a degree to an undocumented immigrant who qualified for the in-state tuition rate unless the individual either filed the affidavit with the institution stating that the individual would apply for citizenship when the individual was allowed to do so or paid the difference between the in-state tuition rate and the higher, nonresident tuition rate.

House Bill 253 also would have exempted an active duty member of the U.S. Armed Forces from nonresident tuition at a Maryland public institution of higher education. To qualify, the member would have been required to be stationed in Maryland, reside in Maryland, or be domiciled in Maryland. The exemption also would have applied to the spouse or financially dependent child of a qualified member of the U.S. Armed Forces. In addition, an honorably discharged veteran of the U.S. Armed Forces would have been eligible for resident tuition if the veteran attended a Maryland secondary school for at least three years and graduated from high school in Maryland or received the equivalent of a high school diploma in the State.

Governor's Veto of House Bill 253

In his veto letter, Governor Robert Ehrlich gave several policy reasons for vetoing House Bill 253, all relating to the immigrant tuition provision of the bill. First, the Governor stated that granting in-state status to illegal immigrants violates the spirit of the federal Illegal Immigration Reform and Immigrant Responsibility Act of 1996 and would reward illegal behavior. Secondly, the Governor raised concerns that the fiscal cost to the State was indeterminate and could be potentially large. He noted that additional college students would increase the State's obligations under the Senator John A. Cade community college funding formula (Cade formula). Finally, the Governor raised concerns that the bill would allow undocumented immigrants to take in-state slots from legal Maryland residents.

Fiscal Impact of House Bill 253

Resident Versus Nonresident Tuition Costs

State institutions of higher education vary widely in terms of resident (in-state) tuition costs and the difference between resident and nonresident tuition. For fall 2003, for example, the University of Maryland, College Park charges $5,568 for resident tuition and $16,242 for nonresident tuition, a difference of $10,674. The University of Maryland Baltimore County charges $5,570 for resident tuition and $12,472 for nonresident tuition, a difference of $6,902.

The fall 2003 in-county tuition charge for a local community college in Maryland ranges from $1,860 to $2,700, with a systemwide average of $2,346. The comparable out-of-state resident tuition charge ranges from $4,170 to $7,080, with a systemwide average of $5,837. The average difference between in-county and out-of-state tuition charges for Maryland community colleges is $3,491.

Undocumented Immigrants

While House Bill 253 would have allowed more students to qualify for in-state tuition rates, tuition revenues at State colleges and universities are not expected to decrease under the legislation. This is because institutions accept relatively stable proportions of in-state students from one year to the next, and this practice would not be altered by the bill. For institutions that are trying to attract additional students, the bill could result in a slight increase in tuition revenues.

Unlike public institutions of higher education, community colleges accept all applicants. Therefore, community colleges could incur a reduction in tuition revenues beginning in fiscal 2004 because more students would be eligible for in-state tuition rates under the bill. Accordingly, State aid to community colleges could increase under the Cade formula because undocumented immigrants who qualify for resident tuition would increase full-time equivalent (FTE) student enrollment counts.

It is not known how many additional community college students would be included in the Cade formula's FTE counts as a result of House Bill 253. As an example, Montgomery College, which has the largest foreign born population of all community colleges, estimates that approximately 350 undocumented students are currently enrolled at the college and may be eligible for resident tuition under House Bill 253. Assuming the 350 students consist of the same full-time/part-time mix as the general student population, State expenditures under the Cade formula could increase by approximately $460,000 in fiscal 2007.

Members of the Armed Forces, Dependents, and Veterans

The provisions of the bill authoring U.S. Armed Forces personnel and their dependents and spouses, and honorably discharged veterans of the U.S. Armed Forces to qualify for resident tuition rates would have a minimal impact on State and local finances. All four-year public institutions of higher education in Maryland already offer such resident tuition benefits to active duty armed forces personnel, their spouses, and dependents.

For further information contact: Kevin Hughes Phone: (410) 946/(301) 970-5530

Higher Education

Study Reveals Disparities in Faculty Salaries at Maryland Institutions

Average faculty salaries at Maryland public higher education institutions vary widely in how they compare to their peer universities and colleges in other states. Average salaries at some institutions rank as high as the 100th percentile, while salaries at other institutions rank as low as the 40th percentile. For the analysis, Maryland public institutions were compared to their funding peer institutions in other states, as defined by the Maryland Higher Education Commission (MHEC). For most Maryland institutions, funding at 100 percent of the MHEC guideline level is designed to enable them to be at the 75th percentile in terms of total resources available. Differences in the salary percentile rankings may be affected by a number of factors.

Higher Education Salaries Vary Widely as Compared to Peers

Average faculty salaries at Maryland public higher education institutions vary widely in how they compare to their peer universities and colleges in other states. An analysis of average salaries for full professors, associate professors, and assistant professors conducted this interim by the Department of Legislative Services shows that faculty salaries at some Maryland public institutions rank as high as the 100th percentile, while salaries at other institutions rank as low as the 40th percentile. (See **Exhibit 1**.) In some cases, different levels of faculty at a particular institution have significantly different percentile ranks.

For the analysis, Maryland public institutions were compared to their funding peer institutions in other states. Peer-based funding guidelines are used by the Maryland Higher Education Commission (MHEC) to assess the resources and performance of the University System of Maryland and Morgan State University. Comparisons with peers are intended to show how competitive Maryland institutions are on a national scale. For most Maryland institutions, funding at 100 percent of the MHEC guideline level is designed to enable them to be at the 75th percentile in terms of total resources available. For fiscal 2003, appropriations to the University System of Maryland were at 73 percent of the funding guideline level after cost containment. (See **Exhibit 2**.)

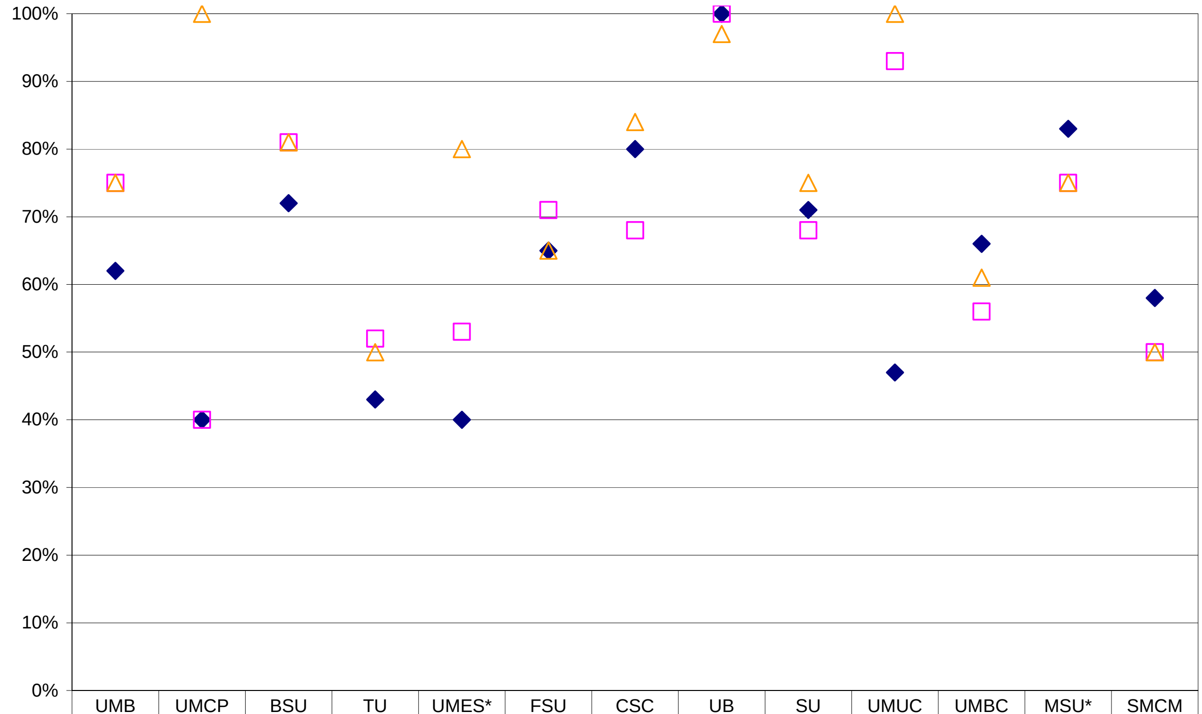
Faculty salary percentile ranks that are inconsistent with funding guideline attainment may indicate how an institution prioritizes faculty salaries in allocating its resources. For instance, University of Maryland Eastern Shore (UMES) has the highest funding guideline attainment (100 percent). It could be expected, therefore, that UMES faculty salaries would be at the 75th percentile rank. As expected, assistant professors at UMES are in the 80th percentile, but associate and full professors are well below this level. The Department of Legislative Services will further analyze the data for all institutions for the fiscal 2005 budget analysis.

Differences in the salary percentile rankings may be affected by a number of factors, including the number of promotions occurring at an institution, a faculty member's time in service, the length of time served at a particular salary classification, and whether the faculty is in a high-demand, high-paying discipline in the larger marketplace. Furthermore, the institutions chosen as peers may not actually have a comparable composition of programs. In the case of University of Baltimore, which has a law school and numerous other graduate programs, only three peers have law schools. Comparisons for the University of Maryland, Baltimore are limited by the salary survey design, which excluded data for the School of Medicine and thereby considered salaries of only one-third of the faculty.

Most (9 of 13) Maryland public institutions have a higher percentile rank for average assistant and/or associate salaries than full professor salaries as compared to their peers. These percentile rankings may indicate that Maryland institutions are recruiting new faculty at the assistant and associate levels who command salaries that are relatively higher in the national marketplace. This is the approach taken by the University of Maryland, College Park as it has improved the quality of its faculty over the last decade, since recruiting high quality full professors requires proportionately more funds. Three institutions (University of Maryland, College Park; University of Maryland Eastern Shore; and University of Maryland University College) have disparities of at least 40 percentage points between their top-ranked and lowest-ranked salary levels.

The analysis is based on data from the American Association of University Professors (AAUP) 2002 through 2003 faculty compensation survey, which uses data from more than 1,400 institutions. The AAUP analysis finds that the gap between faculty salaries at private colleges and universities and public institutions has grown, and the range of salaries among institutions in both the public and private sectors also has increased.

Exhibit 1
Average Faculty Salaries by Percentile Rank Among Peer Institutions 2002-2003



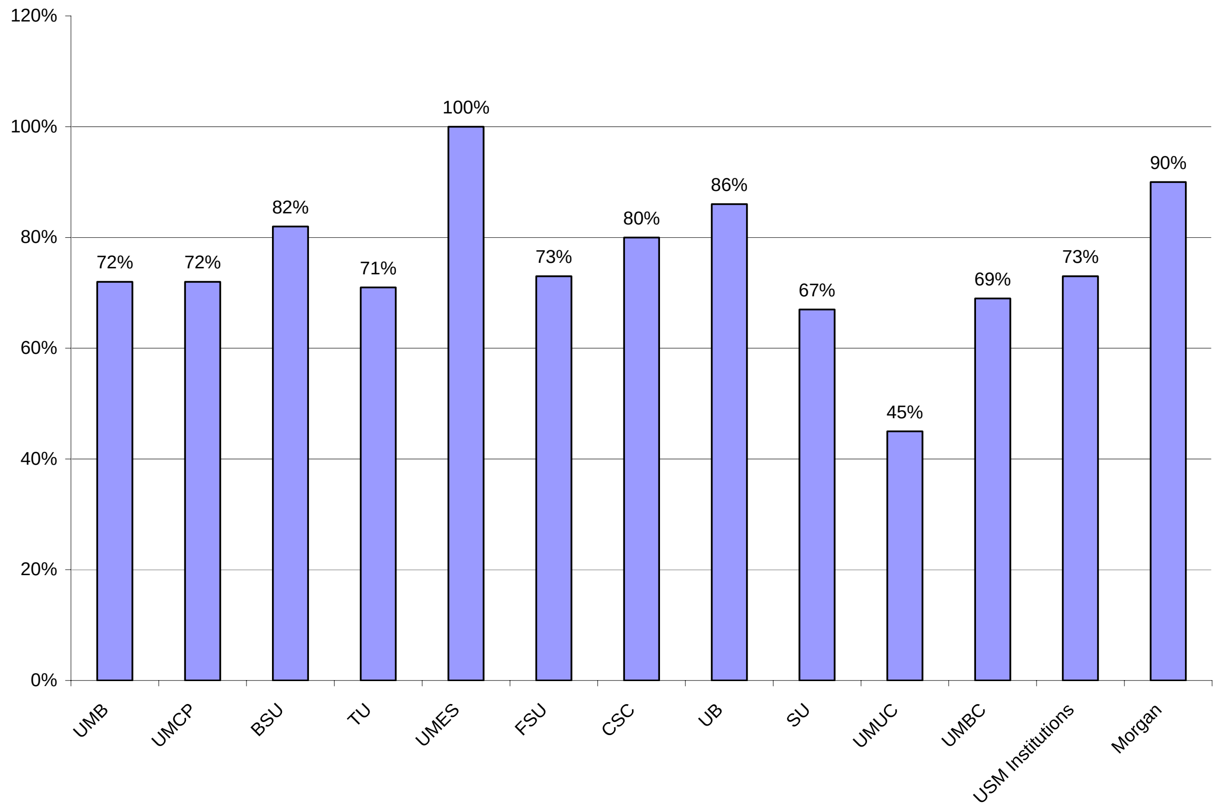
	UMB	UMCP	BSU	TU	UMES*	FSU	CSC	UB	SU	UMUC	UMBC	MSU*	SMCM
◆ Full	0.62	0.4	0.72	0.43	0.4	0.65	0.8	1	0.71	0.47	0.66	0.83	0.58
□ Assoc	0.75	0.4	0.81	0.52	0.53	0.71	0.68	1	0.68	0.93	0.56	0.75	0.5
△ Asst	0.75	1	0.81	0.5	0.8	0.65	0.84	0.97	0.75	1	0.61	0.75	0.5

Note: UMB – University of Maryland, Baltimore
UMCP – University of Maryland, College Park
BSU – Bowie State University
TU – Towson University
UMES – University of Maryland Eastern Shore
FSU – Frostburg State University
CSC – Coppin State College
UB – University of Baltimore
SU – Salisbury University
UMUC – University of Maryland University College
UMBC – University of Maryland Baltimore County
MSU – Morgan State University
SMCM – St. Mary's College of Maryland

*Data was reported by the institution and has not been accepted by the AAUP.

Source: American Association of University Professors Faculty Salary Survey, reported in the Chronicle of Higher Education (chronicle.com/stats/aaup/2003). Prepared by the Department of Legislative Services

Exhibit 2
Funding Guideline Attainment Fiscal 2003



Note: UMB – University of Maryland, Baltimore
UMCP – University of Maryland, College Park
BSU – Bowie State University
TU – Towson University
UMES – University of Maryland Eastern Shore
FSU – Frostburg State University
CSC – Coppin State College
UB – University of Baltimore
SU – Salisbury University
UMUC – University of Maryland University College
UMBC – University of Maryland Baltimore County
USM – University System of Maryland

Source: Maryland Higher Education Commission

Health and Health Insurance

Prescription Drug Assistance Programs

The General Assembly has created a number of programs in recent years intended to increase access to prescription drugs. In addition, the federal government recently granted Maryland a Medicaid waiver to expand prescription drug coverage to a greater number of low- and middle-income seniors. These State-only pharmacy programs will continue to experience enrollment and cost pressure until the full implementation of the federal Medicare pharmacy benefit in 2006.

Background

Prescription drug coverage has become a major issue in recent years, principally because of changes in coverage for seniors. As a result of recent congressional action, Medicare, the national health program for seniors, will include a prescription drug benefit beginning in 2006, although some supplemental Medicare programs currently offer limited prescription drug benefits. The number of Medicare-eligible individuals who lack prescription drug coverage has largely been driven by the increased cost of Medi-Gap policies and the declining number of Medicare HMOs that provide outpatient prescription drug benefits.

The National Conference of State Legislatures reports that 38 states, including Maryland, have some type of senior pharmaceutical assistance program. Legislative activities during the 2000 and 2001 sessions significantly expanded access to affordable prescription drugs to needy seniors in the State. The 2001 legislation also required the Department of Health and Mental Hygiene to apply for a federal Medicaid waiver to supplement funding of these programs.

Maryland Programs Continue to Grow

Several programs have been enacted that provide coverage to the neediest Medicare-eligible residents as well as for indigent individuals who do not qualify for Medicaid. Maryland has four primary programs that provide prescription drug assistance to over 100,000 Medicare enrollees and low income individuals:

- Maryland Pharmacy Assistance Program (MPAP) − established in 1979, its enrollment continues to grow. Since July 2000, enrollment in MPAP has increased nearly 25 percent from 34,700 individuals to just over 47,000 individuals as of July 1, 2003.

- Senior Prescription Drug Program (SPDP) − administered by CareFirst BlueCross BlueShield since 2000, it provides Medicare beneficiaries with access to medically necessary prescription drugs. There are just over 33,000 individuals enrolled in SPDP.

- Maryland Pharmacy Discount Program (MPDP) − implemented on July 1, 2003, it has 500 individuals enrolled. The program covers all medically necessary prescription drugs on the Medicaid formulary and has no monthly premium.

- Medbank − the program, codified in 2001, accesses medically necessary prescription drugs through patient assistance programs sponsored by pharmaceutical drug manufacturers. Medbank has served 23,000 patients statewide.

The SPDP, MPDP, and Medbank programs each contain either eligibility restrictions or sunset provisions contingent upon the availability of a Medicare prescription drug benefit. **Exhibit 1** provides further detail on the prescription drug programs available for Medicare beneficiaries in Maryland.

Exhibit 1

Pharmacy Options for Maryland Medicare Beneficiaries

Program	Income Eligibility Limit for Household of One	Cost Sharing	Benefits
Medicaid	$6,730 for an individual (74% of poverty for aged).	$2 co-pay for brand drugs; $0 co-pay for generic drugs.	All prescription drugs.[1]
Maryland Pharmacy Assistance Program (MPAP)	$10,300 for an individual (116% of poverty); $12,120 for a couple (100% of poverty).[2]	$2.50 co-pay for all generic drugs and some brand name drugs; $7.50 co-pay for certain brand name drugs.	All prescription drugs.[3]
Medbank[4]	Roughly $17,960 (about 200% of poverty). Exact income eligibility limits vary by manufacturer.	None.	Medically necessary drugs available through patient assistance programs.
Maryland Pharmacy Discount Program (MPDP)	$15,715 (175% of poverty). Enrollment limited to Medicare beneficiaries.	$1 processing fee per prescription plus 65% of retail prescription cost after Medicaid discount. Medicaid discount ranges from 5% to 20%.	All prescription drugs.
Senior Prescription Drug Program (SPDP)[5]	$26,940 (300% of poverty). Enrollment limited to Medicare beneficiaries.	Monthly premium of $10 plus co-pays of $10, $20, or $35 depending on the drug; annual benefit may be capped at $1,000.	All prescription drugs.

[1] The Maryland AIDS Drug Assistance Program is open to Medicare clients who meet clinical and income guidelines for HIV/AIDS drugs on the State's formulary.

[2] Chapter 270 of 2003 altered the eligibility for MPAP. As a result, individuals are eligible for MPAP if their annual income does not exceed 116% FPG; families of two or more are eligible for MPAP if their annual household income does not exceed 100% of FPG.

[3] The MPAP formulary was expanded on October 1, 2002, to include all drugs available to Medicaid enrollees as a result of the federal waiver granted in July 2002.

[4] Medbank helps link low-income uninsured individuals with patient assistance programs sponsored by pharmaceutical companies. This program was extended until June 30, 2006, by Chapter 236 of 2003.

[5] Chapter 153 of 2002 renamed and altered both the funding mechanism and regulatory oversight of the Short-term Prescription Drug Subsidy Plan. As of July 1, 2003, the Senior Prescription Drug Program provides Medicare beneficiaries who lack prescription drug coverage with access to affordable, medically necessary prescription drugs until such time as an outpatient prescription drug benefit is provided through the federal Medicare program or June 30, 2005, whichever comes first. The program is administered by CareFirst BlueCross and BlueShield.

Sources: Department of Health and Mental Hygiene; Department of Legislative Services

---

In 2002, the State secured a waiver from the federal government that funds 50 percent of the costs of the MPAP program and expanded the formulary to include all prescription drugs, which mirrors the Medicaid formulary. Prior to waiver approval, MPAP had been 100 percent general funded, and the benefit package was limited to anti-infectives and maintenance drugs. The federal waiver saved the State approximately $22 million during fiscal 2003, primarily from the 50 percent federal match for MPAP. The Department of Legislative Services (DLS) projects that the net savings will dwindle to about $10 million in fiscal 2004 due to MPDP implementation and MPAP enrollment increases.

Despite these cost savings, DLS has raised concerns in several analyses that MPDP and SPDP are somewhat duplicative and could prove confusing to consumers. For example, it is not immediately evident whether a person with an income below 175 percent of poverty would want to participate in MPDP or SPDP. Often, the appropriate program choice will depend on a combination of factors, including the type of drug prescribed, the State's discount on that drug, or how the drug is categorized on a particular plan's formulary. The local areas on aging have insurance advisory programs that assist seniors in determining which programs are the best fit for their utilization patterns and ability to pay.

Medicare Prescription Drug Benefit Approved

In November 2003, Congress passed legislation establishing a voluntary prescription drug benefit for Medicare-eligible individuals. The Medicare Prescription Drug Improvement and Modernization Act of 2003 is expected to be signed by the President on December 8, 2003.

Six months after the Medicare legislation is signed by the President, a pharmacy discount card will become available for purchase by all Medicare enrollees. These cards will provide estimated discounts of 15 percent or more off the retail price of a drug. Under the legislation, Governors, state health departments, beneficiaries, and others must identify administrative problems in coordinating Medicare plans with the existing state plans before the drug benefit is available in 2006.

The key consideration for Maryland is the impact of the new Medicare program on individuals who are dually eligible for Medicare and Medicaid and on current State programs that serve the dually eligible. The Department of Legislative Services will provide a more detailed analysis of the impact of the Medicare prescription drug legislation in early 2004.

For further information contact: Shannon M. McMahon/Erin R. Hopwood Phone: (410) 946/(301) 970-5510

Health and Health Insurance

Medical Malpractice Insurance

The issue of access to, and availability of, medical malpractice insurance resurfaced nationally in 2002. No common explanation has been agreed upon, and states have responded in a variety of ways. Although many Maryland physicians will see a steep rise in premiums in 2004, the State does not yet appear to be suffering the extent of problems exhibited elsewhere.

Background

Recent national attention has focused on what some are calling a medical malpractice insurance crisis. There is evidence in at least some parts of the country to support the claim that medical malpractice insurance is becoming dangerously unaffordable and/or unavailable, especially for individuals practicing in certain high-risk specialties such as obstetrics, neurosurgery, and orthopedic surgery. Manifestations of the problem include steep premium increases, the withdrawal of major insurance companies from the medical malpractice market, insurer-instituted moratoriums on the issuance of new policies, the closure of trauma centers and hospital maternity wards, the elimination of obstetrics from the practices of OB/GYNs, an exodus of physicians from certain areas, and increases in early retirements.

In June 2003, the General Accounting Office (GAO) published a report that studied the extent of increases in medical malpractice insurance rates, analyzed the factors contributing to these increases, and identified any market changes that might make this period of rising insurance premiums different from previous such periods. GAO found that the largest contributor to increased premiums rates was insurer losses on medical malpractice claims. This finding is tempered by a lack of comprehensive data available on either the federal or state level. Other contributing factors to current premium rate increases include decreased investment income, artificially low premium rates adopted while insurers competed for market share during boom years, and higher overall costs due largely to increased reinsurance rates for medical malpractice insurers.

Another GAO report issued in August 2003 found that in the five states it studied with reported health care access problems, many of the actions that health care providers were reportedly taking in response to rising malpractice premiums (e.g., reducing high risk services or practicing defensive medicine) were not substantiated or did not affect access to health care on a widespread basis.

Until this year, the medical malpractice insurance industry in Maryland had not experienced the steep rate increases that had occurred in other states. However, in June 2003 the Medical Mutual Liability Insurance Society of Maryland, the insurance provider to most of the State’s doctors in private practice, requested a 28 percent rate increase in medical malpractice insurance premiums. On August 15, 2003, the Maryland Insurance Commissioner approved the request. The new rate becomes effective January 1, 2004, for new and renewal policies. Opponents of the rate increase argued that a 3.7 percent rate increase was sufficient and that Medical Mutual was seeking to set aside more money than it would likely need for malpractice claims.

Other States' Responses

Over the course of 2003, other states have been considering a variety of initiatives to alleviate the problems in the medical community created by the medical malpractice insurance crisis. These initiatives include tort reform measures such as caps on non-economic and punitive damages; limits on medical care provider liability; reforms to statutes of limitations, collateral source rules, and joint and several liability rules; and good faith hearings. Other initiatives include changes to physician discipline statutes, increased regulation of insurers, and even a tax on every office visit to a doctor. **Exhibit 1** summarizes the responses of other states to the medical malpractice crisis.

Exhibit 1

Other States' Responses to Medical Malpractice Insurance Crisis in 2003

Tort Reforms

Alabama	Passed caps on damages in civil suits against nursing homes.
Arkansas	Passed reform laws on joint and several liabilities; changes burden of proof requirement in certain malpractice cases; requires certification of suit by physician.
Florida	Passed comprehensive reform of system including caps on non-economic damages, health care provider liability; freezes premium rates; may roll back rates.
Idaho	Passed reduction on caps on non-economic damages; caps may be broken on recommendation of Idaho Industrial Commission in certain cases.
Montana	Repealed requirement of unanimity on decisions regarding liability and amounts for punitive damages judgment by a judge or jury.
New Hampshire	Passed law that prevents medical malpractice suits based on "loss of opportunity" for an improved life.
New Jersey	Rejected legislation for caps on non-economic damages and direct cash subsidy for premiums for hardest hit doctors.

Ohio	Passed amendment to statute of limitation for filing a claim; allows introduction of collateral source benefits; allows defendant to call for good faith hearing; caps on noneconomic damages; limits attorney fees.
Texas	Passed caps on non-economic damages – limits based on number and type of defendant.
Utah	Passed changes to binding arbitration requirements between enrollee and health care provider; requires informed renewal of binding arbitration requirement; immunity for certain charity care.
West Virginia	Passed caps on non-economic damages; introduction of collateral source benefits; tax credit for certain percentage of medical malpractice insurance premium.
	Physician Discipline
Nevada	Passed legislation that elevates evidentiary standard required for physician disciplinary hearings to clear and convincing; five- to six-member majority required to find physician guilty of malpractice.
New Jersey	Interested parties seeking legislation to lower required insurance liability limits for physicians.
	Insurer Regulation
Nevada	Passed insurer notice requirement to state insurance agency before insurer can leave state; banned increase on premiums based on investment losses.
	Studying the Issue
Connecticut	No details available.
Oregon	Recommending caps on damages, certification of malpractice suits by physicians.
Pennsylvania	Comprehensive reform recommended including cuts to premiums, cuts on premiums to state-run malpractice catastrophic loss fund, greater authority to discipline repeat offenders, taxes on every office visit.

Sources: National Conference of State Legislatures and state laws.

Federal Response

In 2003, Congress again contemplated legislative responses to the medical malpractice crisis. The Help Efficient, Accessible, Low-Cost, Timely Health Care (HEALTH) Act of 2003, H.R. 5, passed the House of Representatives in March but has not yet been acted on in the Senate. A previous version, H.R. 4600, was introduced and failed last year. Action on a companion measure, S. 11, The Patients First Act of 2003, has been blocked in the Senate. This year's legislation would have, among other things, capped non-economic damages at $250,000; limited the availability of punitive damages; required malpractice lawsuits to be brought within three years of the date of injury or one year of discovery; limited contingency fees; permitted introduction of collateral source benefits; authorized periodic payment of future damages to claimants in cases where the award is at least $50,000; and preempted State law unless it imposes greater protections for health care providers and organizations from liability, loss, or damages.

Conclusion

It is likely that the General Assembly will be asked to address the medical malpractice insurance issue during the 2004 session. Interested parties may seek review of State tort reform laws, including lowering non-economic damage caps and limiting attorney fees, as well as regulating medical malpractice insurers. For further discussion of potential tort reform proposals, see the "Tort Issues" paper under the Civil Proceedings section of this book.

For further information contact: Stacy M. Goodman/Susan H. Russell Phone: (410) 946/(301) 970-5350

Health and Health Insurance

CareFirst

In March 2003, the Maryland Insurance Commissioner denied a request from Carefirst, Inc., to be acquired by WellPoint Health Networks, Inc., and convert to a for-profit. The fall-out from that decision and the legislation enacted in 2003 concerning the mission and governance of CareFirst is still being felt.

2003 Reforms Stir Controversy

Chapters 356/357 of 2003 reformed the statutory framework for CareFirst, Inc., the State's largest nonprofit health service plan. The legislation was passed in response to the March 5, 2003 order by the Maryland Insurance Commissioner disapproving a request by CareFirst to be acquired by WellPoint Health Networks, Inc. and to convert to for-profit status. Although this legislation was subject to legal challenge by the national BlueCross BlueShield Association and CareFirst, the parties ultimately entered into a June 2003 consent decree to avoid protracted litigation. The changes to the CareFirst mission and governance remain under review by the insurance commissioners of Delaware and the District of Columbia. Although CareFirst, Inc., the holding company for the Maryland, Delaware, and District of Columbia health plans, is domiciled in and licensed by Maryland, the health plans operating in the individual jurisdictions are licensed by those jurisdictions. During its review of the CareFirst application to for-profit status, the Maryland Insurance Administration (MIA) uncovered troubling aspects of the conduct of CareFirst executives and directors. Since the enactment of the reform legislation, both MIA and federal law enforcement authorities have conducted further investigations detailed below.

Nominating Committee for the CareFirst, Inc. Board of Directors

The law and the consent decree provide for the establishment of a nine-member nominating committee to select candidates to serve as the 12 Maryland representatives on the Board of Directors of CareFirst, Inc. The nominating committee, which held its first meeting on September 3, 2003, will initially select five individuals to serve on the board beginning January 1, 2004. The committee will also identify a list of qualified candidates to fill the remaining seven positions beginning July 1, 2004, and provide the list to the CareFirst board. The board, including the five members selected by the nominating committee, will then select the last seven members from this list. The nominating committee intends to make its selection of the five direct appointees no later than December 2003.

Potential Break-up of CareFirst, Inc.

Following enactment of the CareFirst reform legislation, the Delaware Insurance Commissioner called for hearings to evaluate, and if necessary, change the Delaware Insurance Department Order that allowed and set the terms for the CareFirst/BlueCross BlueShield of Delaware affiliation. In response to this threat, the CareFirst board announced on September 17, 2003, its agreement in principle to modify its affiliation agreement with the Delaware plan. The hearings commenced November 4, 2003. The CareFirst board approved a request from the BlueCross and BlueShield Delaware board to return majority control of the Delaware Plan to the Delaware board. The Delaware Blues Plan would remain a contractual affiliate of CareFirst. The CareFirst board also agreed to support the Delaware affiliate in obtaining a separate license to operate under the BlueCross BlueShield trademark.

Similarly, the District of Columbia CareFirst affiliate, Group Hospitalization and Medical Services, Inc. (GHMSI), approached the CareFirst board seeking an arrangement similar to that obtained by Delaware that would allow GHMSI to modify its affiliation agreement and return majority control of the GHMSI plan to the District of Columbia board. Unlike the agreement reached with the Delaware plan, the CareFirst Board took no action on the GHMSI request, wanting time to bring in a consultant to examine the ramifications of the request. This action prompted the District's Insurance Commissioner to issue an order prohibiting the CareFirst Board from making any changes to its corporate structure without first obtaining the District Insurance Commissioner's prior written approval. A hearing on the matter is scheduled on November 24, 2003.

Currently, CareFirst, Inc., holds a single license for the three affiliated plans serving Delaware, Maryland, and Washington, DC. Any change to the affiliation agreement among CareFirst and its three affiliate plans must be approved by the insurance commissioners in all three jurisdictions. As of mid-November 2003, the Maryland Insurance Commissioner had not yet received an application from the Delaware or DC affiliates for a change to the affiliation agreement.

Investigations into Conduct of CareFirst Executives and Directors

The CareFirst reform law also required the Maryland Insurance Commissioner and the Attorney General to review the March 2003 Maryland Insurance Administration Order issued on the for-profit conversion and acquisition for the purpose of:

- Determining whether any of the conduct identified in the order violates any provision of the Insurance Article or any provision of federal or State civil, criminal, or administrative law; and

- Making recommendations regarding whether changes to Maryland law need to be made to ensure that regulatory oversight of nonprofit health service plans is sufficient to protect the public interest.

The commissioner issued his report on these matters on July 8, 2003, and the Attorney General issued his report on September 2, 2003. The commissioner's report identified a number of proposed violations and the actions, including civil charges, that would be taken to address the violations. Both reports made recommendations for strengthening provisions of State law concerning actions of nonprofit health service plan directors and use of conversion and acquisition proceeds.

In August 2003, *The Baltimore Sun* reported that federal investigators had subpoenaed extensive records of CareFirst in a probe of the conduct of the company and its officers in attempting to convert to a for-profit operation and sell itself to WellPoint. Upon learning of the federal investigation, MIA suspended action on the civil charges until a later date.

Oversight Committee

The CareFirst reform law provided for creation of a 17-member Joint Nonprofit Health Service Plan Oversight Committee. Membership consists of two senators, two delegates, and 13 members representing specified stakeholder groups, appointed jointly by the President of the Senate and Speaker of the House. The committee is charged with examining and evaluating the ability of the nonprofit health service plans in the State that carry the BlueCross and BlueShield trademark to meet certain identified goals. As of mid-November 2003, the committee has not yet been appointed.

Health and Health Insurance

Cigarette Restitution Fund Spending

Tobacco settlement revenue is at a minimum from fiscal 2004 to 2007, a period when the State's legal and health-related commitments are at their highest levels. Preserving Cigarette Restitution Fund programs will require increased general fund support for Medicaid, a difficult proposition given the State's fiscal condition.

Background

In 1998, the five major tobacco companies settled all outstanding litigation with 46 states, five territories, and the District of Columbia. The result was the Master Settlement Agreement, a document that established the companies' financial obligations to the states as well as a number of restrictions for marketing tobacco products to youth and the general public.

In anticipation of receiving tobacco settlement revenue, the State established the Cigarette Restitution Fund, a special nonlapsing fund to be used for a variety of health- and tobacco-related programming. In the 2000 and 2001 sessions, the General Assembly established three distinct programs to address the causes and effects of tobacco use: the Tobacco Use Prevention and Cessation Program; the Cancer Prevention, Education, Screening, and Treatment Program; and a crop conversion plan developed by the Tri-County Council of Southern Maryland. After initial implementation delays, each of these programs is now fully operational.

Tobacco Settlement Revenue at a Minimum through Fiscal 2007

The Master Settlement Agreement established three types of payments that vary in their terms and amounts: initial, annual, and strategic contribution payments. As only annual payments are due in fiscal 2004 through 2007, the amount available to the Cigarette Restitution Fund is at a low ebb during this period. Specifically, the three payment streams consist of the following:

- Initial payments were scheduled from 1998 through 2002. Maryland received annual initial payments of approximately $60 million for each of the five years.

- Annual payments began in 2000 and will continue as long as the settling manufacturers continue to ship tobacco products domestically. Annual payments are adjusted annually based on domestic consumption of tobacco products and inflation. Maryland's annual payment is expected to vary between $140 and $150 million in the near future.

- Strategic contribution payments, beginning in fiscal 2008 and continuing through fiscal 2017, reflect states' legal contributions to the tobacco settlement. Maryland's share of these payments is estimated at $28 million annually.

In addition to these three payment streams, the National Arbitration Panel established by the Master Settlement Agreement awarded the State $132 million for legal costs associated with the tobacco settlement. Annual award payments, which began in fiscal 2003, are estimated between $5 and $6 million each year.

Cigarette Restitution Fund Programs Affected by Fiscal Situation

The State settled its contract dispute with the Law Offices of Peter G. Angelos, P.C. in April 2002 making available $93 million held in escrow pending resolution of the case. The Budget Reconciliation and Financing Act of 2002 stipulated that any disbursement to the State as a result of such a settlement would be credited to the Cigarette Restitution Fund. Furthermore, it required that the first $20 million from the escrow account be dedicated to the Cigarette Restitution Fund's cancer and tobacco programs with the next $73 million dedicated to the Maryland Medical Assistance Program (Medicaid). The increased fiscal 2003 appropriation for the cancer and tobacco programs was ultimately withheld for cost containment; however, the additional $73 million remained in the Medicaid budget, increasing the fiscal 2003 appropriation of Cigarette Restitution funds to that program to $104 million.

The fiscal 2004 appropriation of Cigarette Restitution funds to Medicaid was maintained at $107 million. With less total revenue available from the tobacco companies and a smaller fund balance at the beginning of the fiscal year, funding for several programs was reduced to maintain level Medicaid spending from fiscal 2003 to 2004. Had Cigarette Restitution Fund support for Medicaid decreased over that period, the State would have had to find an offsetting amount of general funds to compensate, a difficult proposition given the State's fiscal condition.

The State faces a similar situation in fiscal 2005. There will be an estimated $59 million less in the Cigarette Restitution Fund at the beginning of fiscal 2005 than at the beginning of fiscal 2004 (see **Exhibit 1**). If current Medicaid funding levels are maintained in fiscal 2005, less than $20 million will be available for all other priorities. Conversely, reducing funding for Medicaid puts additional pressure on the general fund to support that program at a time when financial resources are already overcommitted. As resources are limited, close review of Cigarette Restitution Fund programs will allow the General Assembly to prioritize funding according to need and responsiveness to the public health demands caused by tobacco use.

Exhibit 1

Estimated Cigarette Restitution Fund Receipts and Expenditures

Fiscal 2004 – 2010
($ in Millions)

Year	Balance	Est. Tobacco Settlement Revenue	Settlement Payment to Law Offices	Health	Crop Conversion	Education	Ending Balance
2004	63	151	-30	-172	-6	-3	4
2005	4	152	-30	-172	-6	-3	-54
2006	0	151	-30	-172	-6	-3	-60
2007	0	153		-172	-6	-3	-28
2008	0	183		-172	-6	-3	2
2009	2	185		-172	-6	-3	6
2010	6	186		-172	-6	-3	11

Note: Balance includes release of $13 million in reserves in fiscal 2004.

Sources: Department of Budget and Management, Department of Legislative Services

Health and Health Insurance

Medicaid Enrollment and Trends

The growth in the State's Medicaid program continues to outpace that of general trend revenues and remains a major driver of State spending. Anticipated fiscal 2003 and 2004 deficits will be offset by a temporary increase in the federal Medicaid match as well as recent cost containment actions. However, general fund demands in fiscal 2005 may be exacerbated by a drop in Cigarette Restitution Fund monies available to Medicaid.

Overview

Maryland's Medicaid and Children's Health Programs provide eligible low-income individuals with comprehensive health care coverage. Funding is derived from both federal and State sources with a federal fund participation rate of 50 percent for Medicaid and 65 percent for the Maryland Children's Health Program (MCHP). Most Medicaid/MCHP recipients are required to enroll with a managed care organization (MCO).

Medicaid accounts for about 15 percent of State general fund expenditures and is one of the fastest growing segments of the State budget. Over the next five years, Medicaid costs are expected to rise at a rate of about 8 percent annually while general fund revenues are forecast to grow at a more moderate 4 percent clip. Failure to constrain Medicaid costs or identify additional revenue streams will ultimately result in Medicaid squeezing out funding for other programs.

Fiscal 2004 Forecast

In an effort to constrain Medicaid spending, the Board of Public Works in July approved reductions to the fiscal 2004 Medicaid budget of $50.4 million in general funds. The reductions will also result in the loss of $38.4 million in federal matching dollars. Specific cost-cutting measures include:

- Limiting the number of hospital days that the State will finance for certain adults. While the board anticipated $40 million of savings from a January 2004 implementation, the Department of Health and Mental Hygiene (DHMH) advises that the State will save only $20 million. To defray the expected increase in uncompensated care at hospitals, the Health Services Cost Review Commission will raise hospital rates.

- Freezing the medical day care rate at the fiscal 2003 level and reducing planned rate increases for nursing homes and MCOs to 4 percent and 5.3 percent, respectively. The three actions will save $13.6 million if implemented as planned in January 2004.

- Pursuing supplemental rebates from drug manufacturers seeking the inclusion of their products on the preferred drug list ($4 million) and changing the method of accounting for the existing prescription drug rebates from manufacturers ($20 million).

- Increasing the discount the State receives from pharmacies for the prescription cost of the drug from the 11 to 12 percent of the average wholesale price ($2.2 million).

- Reducing uncompensated care payments to District of Columbia hospitals ($2 million).

- Deferring expansion of the Waiver for Older Adults by 500 slots ($3.0 million).

- Reducing funds for case managers in the Rare and Expensive Case Management Program to recognize that many participants are medically stable and no longer require active case management ($2 million).

- Claiming federal funds to cover 50 percent of the costs of emergency services for legal aliens. No net savings are achieved from this action since federal funds substitute for general funds, but general fund spending declines by $6 million.

- Combating fraud ($1.0), requiring $1 co-payments for non-emergency transportation services ($0.4), and reducing administrative costs ($0.6 million).

Despite these cost containment actions, the Department of Legislative Services projects a $196 million total fund deficit for the Medicaid program. About $70 million of the deficit is attributable to the payment of unpaid fiscal 2003 bills. The development of the fiscal 2004 budget on an underfunded fiscal 2003 base ($70 million), a higher than anticipated increase in hospital rates ($30 million), and an unbudgeted rate increase for MCOs in calendar 2004 ($40 million) contribute to a $126 million shortfall in fiscal 2004. Final fiscal 2004 expenditures are expected to exceed actual fiscal 2003 costs by about 6.7 percent due to medical inflation and enrollment growth.

No general funds are required to close the combined fiscal 2003-2004 deficits because the federal government has temporarily raised the share of Maryland's Medicaid costs it will cover from 50 to 52.95 percent. The higher match rate results in a $137 million windfall to the State that more than offsets the general fund share ($97 million) of the projected deficit.

Fiscal 2005 Forecast

For fiscal 2005, combined Medicaid and MCHP expenditures of $3.9 billion are anticipated of which almost half will be general funds (see **Exhibit 1**). Expenditure growth of about 8 percent is forecast due to a projected increase in enrollment (3 percent) and medical inflation of about 7 percent. Cost increases are constrained by a shift in the enrollment mix toward children who are typically less expensive to serve than the elderly and disabled. The annualization of various fiscal 2004 cost containment actions also curbs the growth in spending.

Exhibit 1
Enrollment and Service Year Expenditures*
Fiscal 2003 – 2005

	FY 2003 Actual	FY 2004 Approp.	FY 2004 Estimate		FY 2005 Estimate	% Change FY 04 – 05
Enrollment by Category						
Medicaid	482,308	496,100	494,900		509,455	3%
MCHP	113,201	121,000	116,000		121,366	8%
Total	**595,509**	**617,100**	**610,900**		**630,821**	**3%**
Cost per Medicaid/MCHP Enrollee	$5,676	$5,704	$5,906		$6,200	5%
Total Funds ($ in Millions)**	$3,380	$3,520	$3,608		$3,911	8%
General Funds ($ in Millions)**	$1,542	$1,596	$1,660	***	$1,868	13%

* Expenditures by fiscal year are based on the costs of providing services during that fiscal year rather than the year that the bills were actually paid. Cases and funding associated with the Maryland Pharmacy Assistance Program and the Maryland Pharmacy Discount Program are excluded from the chart.

** The portion of the fiscal 2004 deficit associated with fiscal 2003 expenses is included with fiscal 2003 spending.

*** General fund number does not take into account the enhanced federal match that Maryland will receive in fiscal 2004. After accounting for the match, no additional general funds will be required in fiscal 2004.

Source: Department of Legislative Services

General fund spending is expected to grow at a faster rate than overall expenditures, as the amount of Cigarette Restitution Fund monies available to support the program will decline from $106.6 million in fiscal 2004 to $49.5 million in fiscal 2005 unless significant reductions are made to other programs supported through the Cigarette Restitution Fund.

The combined Medicaid and MCHP enrollment is projected to climb three percent. Enrollment growth is spurred by a rise in the number of children qualifying for Medicaid due to their low incomes and by the removal of impediments to MCHP enrollment imposed for fiscal 2004 only by the Budget Reconciliation and Financing Act of 2003 (a freeze on enrollment above 200 percent of the poverty level and premiums for families with incomes from 185 percent to 200 percent of the poverty level). The rise in enrollment of poor children reflects the weak economy and long-standing enrollment patterns.

Health and Health Insurance

Compensation for Direct Care Workers

Legislation enacted in 2001 requires the Department of Health and Mental Hygiene (DHMH) to increase the rate of reimbursement to community providers in order to eliminate the disparity between State and private direct care wages over a five-year period. Preliminary data raise questions about the implementation of the initiative.

Background

The State's Developmental Disabilities Administration provides direct services to individuals with developmental disabilities in four State residential centers and through funding of a coordinated service delivery system of community services. As the State has shifted emphasis to a community-based system, the administration has increasingly become a purchaser, rather than a provider, of services for the developmentally disabled. Direct care workers employed by private providers are increasingly providing services in supported living arrangements and smaller residential settings that were previously provided exclusively in State institutions.

Direct care workers employed by private providers are not compensated according to the State pay scale, creating disparities in wages relative to equivalent State positions. The 2001 legislation (Chapters 109/110) requires DHMH to increase the rate of reimbursement to community providers in order to eliminate the wage disparity over a five-year period. As required by law, the department has collaborated with the Community Services Reimbursement Rate Commission to survey providers in order to determine the magnitude of the disparity; annual appropriations for the initiative are based on the results of these annual surveys.

Survey Methodology and Results

State law requires private providers to comply with requests for wage survey information and establishes penalties for non-compliance. More than 90 percent of private providers have provided information for the 2003 survey, similar to previous years' participation rates. Private consultants have collected the data and followed up with providers as necessary to verify the information provided. Despite these measures, the accuracy of the data is uncertain. Corrections were recently made to prior year data, altering the reported increase in wages from 2002 to 2003. Inconsistencies also exist in the reported data. For example, significant reductions in the rate of turnover for service workers appear concurrently with reductions in their average length of tenure.

In fiscal 2003, the first year in which funding was provided, $16.2 million was appropriated to resolve 20 percent of the total disparity amount. The administration estimated that the additional funds would increase the total value of direct care wages and fringe benefits by 8 percent. Preliminary data reported by the Community Services Rate Reimbursement Commission show moderate increases in average wages but relative constancy in the value of fringe benefits. The data, detailed in **Exhibit 1**, indicate that the base hourly rate for an aide increased to $9.40, while the base hourly rate for a service worker increased to $9.92. The value of fringe benefits for these employees has remained constant at 20 percent of annual salary, as measured by the survey. However, an alternate survey administered by the Developmental Disabilities Administration shows a moderate increase in the value of fringe benefits, making it unclear whether the 8 percent increase in wages and benefits was fully implemented.

Exhibit 1
Preliminary Compensation and Employment Data for Direct Care Staff Employed by Private Providers

	2001	2002	2003	Change 2002-2003
Aide				
Average hourly rate	$8.64	$8.99	$9.40	4.6%
Turnover	48%	45%	42%	-6.7%
Average tenure (in months)	26	39	30	-23.1%
Service Worker				
Average hourly rate	$9.15	$9.43	$9.92	5.2%
Turnover	35%	44%	24%	-45.5%
Average tenure (in months)	29	45	40	-11.1%

Source: Community Service Reimbursement Rate Commission

Results Raise Questions for the Future of the Initiative

The General Assembly appropriated an additional $14.6 million for the initiative in fiscal 2004 to reduce the total disparity by 18%; another $17.8 million is anticipated for fiscal 2005 to reduce the total disparity by 22%. State law requires that all increases in the rate of reimbursement resulting from the wage initiative be used to increase the compensation of community direct care workers. Based on the results of the survey, it is still unclear what percentage of total funds was passed on to direct care staff. DHMH is now meeting with representatives of the Community Services Reimbursement Rate Commission and the Maryland Association for Community Services in an attempt to determine how funds were used. The administration is also administering a separate survey to determine the total value of the increase in direct care wages and benefits. These results will be critical to determining the future of the initiative.

For further information contact: Suzanne M. Owen Phone: (410) 946/(301) 970-5530

Health and Health Insurance

HIV and AIDS in Correctional Facilities

Inmates in Maryland comprise 13 percent of all persons in the State infected with HIV/AIDS. Mandatory screening of inmates for HIV/AIDS is not required in Maryland unless a correctional officer has been exposed to the disease. Other states have different testing protocols as well as discharge models.

Background

As of June 2003, an estimated 25,424 Marylanders had HIV or AIDS, with nearly 10 percent in the custody of the Maryland Department of Public Safety and Correctional Services (DPSCS). A recent report by the Department of Health and Mental Hygiene and DPSCS found that prisoners are disproportionately HIV infected, representing less than one percent of Maryland's population, but more than 13 percent of HIV cases. In Maryland, an estimated 4.7 percent of inmates are HIV infected, compared with 2.2 percent of state prison inmates nationally. This high prevalence of HIV makes correctional facilities increasingly important in the control of HIV and AIDS in Maryland. An understanding of current protocols for HIV screening and treatment, prevention practices in other states, and fiscal considerations may help to guide HIV/AIDS treatment and prevention policies and reduce Maryland's high prevalence of disease among the incarcerated population.

Current Protocols

The only mandatory screening tests for inmates/detainees in State correctional and detention facilities are for tuberculosis and syphilis. Inmates/detainees are encouraged to be screened for HIV and, if tested positive, receive a treatment plan based on current medical protocols. HIV testing is required in the event that an inmate/detainee may have exposed a correctional officer to the disease.

DPSCS partners with the Baltimore City Health Department and local health care organizations to provide educational programs and services. To prepare inmates/detainees for discharge, DPSCS' Division of Corrections has an interagency agreement with the Department of Human Resources to complete applications for Medicaid benefits for inmates/detainees 30 days prior to release. DPSCS helps inmates/detainees apply for Social Security and Supplemental Security Income benefits and for Maryland Pharmacy Assistance Program or Maryland Aids Drug Assistance Program services to provide access to medications. DPSCS also works with the inmate medical contractors to provide inmates with up to a 30-day supply of medications consistent with the inmate/detainee's aftercare plan.

None of the local jurisdictions mandates testing for HIV in local detention centers; however, all assist inmates/detainees in getting screened for HIV if requested by the inmate/detainee. In many jurisdictions, the local health department covers the costs associated with testing, while other jurisdictions fund the costs of screening through their detention budgets. Although few measure outcomes, each detention center provides some type of continuity or transitional assistance to inmates/detainees.

Prevention Practices in Other States

States across the country have targeted inmates/detainees as a starting point for implementing HIV/AIDS prevention and treatment programs. Several states have implemented prevention programs, while others have received federal funding to develop and maintain HIV prevention, case management, and discharge planning programs for HIV positive inmates.

Currently, 11 states and Puerto Rico require testing of prisoners regardless of the crimes they have committed. Several states that require testing also require prevention programs. Alabama, California, Kentucky, Michigan, Nevada, Ohio, Rhode Island, and Texas require both treatment and education programs. Unfortunately, prisons run into a variety of problems when implementing education/prevention programs for inmates. Approximately 50 percent of U.S. inmates are functionally illiterate and many do not speak English as their first language. Individual counseling, peer counseling, support groups, and programs for women, designed for and by inmates, have been successful in many prisons and may prove to be the best educational tools.

Many states attempt to ensure continuity of care and follow-up of HIV infected inmates once they have been released from prison. Discharge planning can take a variety of forms, from providing pamphlets about outside resources to coordinating care with outside community-based organizations that assist inmates with their health care needs during their transition back into the community. Four states (California, Massachusetts, New Jersey, and New York) offer comprehensive discharge planning programs, which are either locally-based or statewide, in which the prison system partners with outside community-based organizations to provide a continuum of care for HIV positive inmates.

Conclusion

The current costs for screening and treatment for inmates/detainees in Maryland are covered by the inmate medical care contract. The providers are private vendors that contract with the State to provide medical services to the inmate/detainee population. The costs for treatment of inmates/detainees who test positive for HIV or AIDS are unknown because these costs are built into the medical contract. In any event, they can be expected to grow as the inmate population (and consequently the number of inmates with HIV) continues to grow.

For further information contact: Jennifer B. Chasse/Susan John Phone: (410) 946/(301) 970-5530

Health and Health Insurance

State-run Psychiatric Facilities

Although the number of beds in State-run psychiatric hospitals and the average daily census at those hospitals have declined dramatically in the past 20 years, the State has only closed one hospital in that time. At the request of the legislature, the Department of Health and Mental Hygiene (DHMH) has recently submitted a report recommending the reconfiguration of State psychiatric hospital beds that maintains current capacity and closes Crownsville Hospital.

Background

The fiscal 2004 budget bill included language expressing legislative intent that the State should have a network of State-run psychiatric facilities with only two large regional hospitals rather than the current three while maintaining existing overall bed capacity. The language withheld $2 million from the appropriation of the Mental Hygiene Administration pending a report from DHMH providing for such a network. The report was also to include a time-line to facilitate transition to the reconfigured hospital capacity.

Consolidation of State-operated psychiatric bed capacity is not a new issue. However, despite a decline of operated beds in State-run psychiatric hospitals by 69 percent between 1982 and 2001 and a decline in the average census at those hospitals by 62 percent in the same period, the State has closed only one hospital, Highland Health in 1998.

DHMH Report

In October 2003, DHMH submitted the required report, which recommends that Crownsville Hospital be closed. The report affirmed the legislative intent of the budget bill language that it is indeed possible to operate a network of State psychiatric hospitals with only two, rather than the current three, large regional hospitals. The revised bed reconfiguration would add beds throughout the remaining seven primarily adult-serving institutions, but mainly at Spring Grove, Springfield, and Perkins (see **Exhibit 1**).

Exhibit 1
State-run Psychiatric Hospitals
Proposed Bed Reconfiguration

	Current Capacity	Fiscal 2003 Budgeted Beds	Fiscal 2003 ADP	Reconfigured Budgeted Beds	Revised Capacity
Carter	84	49	49	66	84
Crownsville	324	202	197	0	0
Eastern Shore	80	78	74	80	80
Finan	119	80	74	100	119
Perkins	235	206	217	254	263
Spring Grove	415	277	273	377	415
Springfield	358	275	267	338	358
Upper Shore	64	37	37	37	64
Total	**1,679**	**1,204**	**1,188**	**1,252**	**1,383**

Source: Department of Legislative Services

The report emphasizes that closing Crownsville and reconfiguring the current system can be done while still meeting the following goals:

- Maintaining current bed capacity. The current budgeted operating capacity is 1,204 beds, and the report proposes a system with 1,252 budgeted beds.
- Meeting anticipated service needs. The report leaves the system with a total capacity of 1,383 beds, thereby allowing for growth or further reconfiguration depending upon other policy directions the department may choose to follow.
- Maintaining standards for patient care. The department emphasizes that patient care will not be compromised.
- Maintaining hospital accreditation.
- Generating operating budget savings. The report estimates gross annual savings of just under $12 million in the first full year of closure, although the department proposes to use $6 million in savings for one-time renovation costs and $5 million for an ongoing investment in community resources aimed at preventing hospitalization.
- Generating capital budget savings. It has long been recognized that Spring Grove and Crownsville facilities require modernization. However, there has been little appetite to

build two new hospitals. Although new hospitals have been proposed for both sites and have been included in the Capital Improvement Plan, neither have reached the stage of being included in the capital budget bill. The report resolves the need to build two new State hospitals and will result in future capital savings of almost $100 million.

The report notes that closure is a difficult proposition, with numerous patient, patient family, employee, and tenant issues to resolve. The report also includes a detailed time-line and transition plan.

Other Issues

In addition to reconfiguration, the report raised four other issues:

- Since 1997 Maryland has had an Institution for Mental Disease waiver that allows the State to bill Medicaid for the treatment of eligible individuals ages 21-64 in freestanding psychiatric hospitals. That waiver will end after fiscal 2005, and the State will either have to expand bed capacity to accommodate these admissions (30 beds) or use 100 percent general funds to pay for the placements.
- DHMH is investigating the privatization of the Carter Center in Baltimore with the beds to be operated by the University of Maryland Medical System.
- DHMH is also investigating ending acute care in State-operated psychiatric hospitals, letting the private sector provide this care. This reinforces the current structure of inpatient psychiatric care in Maryland, with most admissions being to private acute care general and freestanding psychiatric hospitals, with the State psychiatric hospitals treating patients on a more long-term basis.
- The percentage of forensic patients in State psychiatric hospitals, currently almost half, has grown rapidly in recent years. These patients have long average lengths of stay and tend to clog hospital beds by remaining in hospitals longer than medically necessary, thereby occupying beds that could be used for other patients.

Next Steps

The Department of Legislative Services has recommended that DHMH implement the report's recommendations and reconfigure its bed capacity by closing Crownsville, pursue other potential changes to the hospital system, and establish a dialogue with the Judiciary concerning the appropriate placement of forensic patients in State psychiatric hospitals. These recommendations are currently awaiting legislative action.

For further information contact: Simon G. Powell Phone: (410) 946/(301) 970-5530

Health and Health Insurance

Small Group Market Reform

After achieving initial success in opening up health insurance to more individuals, economic and health care cost pressures are beginning to squeeze people from coverage under the Comprehensive Standard Health Benefit Plan (CSHBP). The cost of CSHBP has prompted changes to cost-sharing provisions, but these changes will only provide short-term relief. Deeper reforms are necessary, and other states are grappling with the same dilemma.

Comprehensive Standard Health Benefit Plan

The Comprehensive Standard Health Benefit Plan (CSHBP) was established in 1994 as a result of health care reforms adopted by the General Assembly to provide better access to coverage in the small group market at an affordable price. CSHBP is a standard health benefit package that carriers must sell to small businesses (50 or fewer employees) that choose to offer health insurance coverage to their employees. While the small group market reforms achieved early success in increasing the number of individuals with health insurance, more recently the stagnant economy, coupled with soaring health care costs, has eroded that initial success. In 2002, the number of covered lives in the small group market declined for the fourth consecutive year (down 1.7 percent to 448,080). The steady decline in the number of covered lives has prompted demands for changes in the types of plans and cost-sharing arrangements that may be offered.

Small Business Health Insurance Affordability Act

The Maryland Health Care Commission (MHCC) is responsible for the design and annual review of CSHBP. If MHCC finds the average rate for the standard benefit plan across all carriers and delivery systems exceeds or is projected to exceed the statutory cap on cost (10 percent of Maryland's average annual wage), MHCC must modify CSHBP by increasing the cost-sharing arrangements or decreasing benefits.

In its annual review of CSHBP dated September 18, 2003, MHCC staff estimated that the average rate for the standard benefit plan would exceed the 10 percent cap in 2003 and would reach 11.5 percent of the average annual wage in 2004. The staff established as an objective a reduction in the cost of the plan to 90 percent of the cap, in order to provide stability in the CSHBP benefit structure. After meeting with stakeholders and holding two public hearings, on October 30, 2003, the commission approved increased cost-sharing provisions to keep overall costs below the statutory cap. Deductibles for preferred provider health plans will increase to $2,500 per person and $5,000 per family, from the current $1,000 and $2,000. Copayments for services will also increase. Copayments for emergency room services, for example, will increase from $35 to $100; and copayments for brand name nonformulary drugs will increase from $30 to $50. Changes to CSHBP will be incorporated in regulations to become effective July 1, 2004.

While implementing the recommendations proposed by MHCC staff will meet the statutory requirement for CSHBP, there is general acknowledgement that they provide only a band-aid and do little to address the underlying problem of health insurance affordability. Long-term solutions center on finding a balance that will bring younger healthier individuals into the market to help subsidize the older less healthy individuals who would otherwise be priced out of the market. Every state is wrestling with this issue.

Small Group Market Insurance Across-the-Country

Nationwide, small firms are less likely than large firms to offer health insurance coverage to their workers. According to an October 2003 report from the Commonwealth Fund, only 46 percent of small-firm workers obtained coverage through their own jobs, compared to 66 percent of large-firm workers. Moreover, the rate of uninsured workers in small firms grew by 25 percent from 1987 to 2001. Small-firm workers and their families accounted for 36 percent of the non-elderly uninsured. Uninsured workers are more likely to have low incomes, work in jobs with high turnover, or work in jobs with seasonal employment.

New "consumer-driven" health plans are receiving a lot of attention across-the-country. These plans typically offer a high deductible policy, coupled with a fixed employer contribution to an account for medical expenses, controlled by the employee. Any portion of the employer contribution remaining in the employee's account at the end of the year is rolled over into the next year. Such plans encourage employees to be price-sensitive and discourage unnecessary health care utilization. Employers opting for these plans report cost savings, at least in the short term. Although some insurance carriers have limited experience with these consumer-driven health plans, overall the plans are still too new to gauge their impact on either the small or large group markets.

Other states are also attempting individual reforms to increase participation among employers in their small group markets. Colorado enacted legislation in 2003 authorizing rate banding in the small group market. Rate banding will allow companies with younger, healthier workers to pay a lower premium than companies with older, less healthy workers. Legislation enacted in Virginia earlier this year authorized cost-sharing, including deductibles, coinsurance, and copayments, for both essential and standard plans sold in the small group market. Insurers have expressed optimism that this cost-sharing flexibility will provide additional options that attract employers to the market.

Prospects for the 2004 Session

Like this past session, the 2004 session is likely to see proposals that open up the small group market to additional options like a basic benefit plan, tighter limitations on preexisting conditions, and greater employee cost-sharing.

Health and Health Insurance

Mental Health Funding

For a fourth straight year, the community services mental health budget appears to require a significant cash infusion to close the gap between expenditures and the original appropriation. The Mental Hygiene Administration may need as much as $126 million in general funds added to its fiscal 2004 and 2005 budgets to cover deficits and meet current service needs. Clearly, attempts to manage the service delivery system in order to constrain growth has to date been unsuccessful. The question remains if improved management of the current system can produce the desired results or if significant overhaul is required.

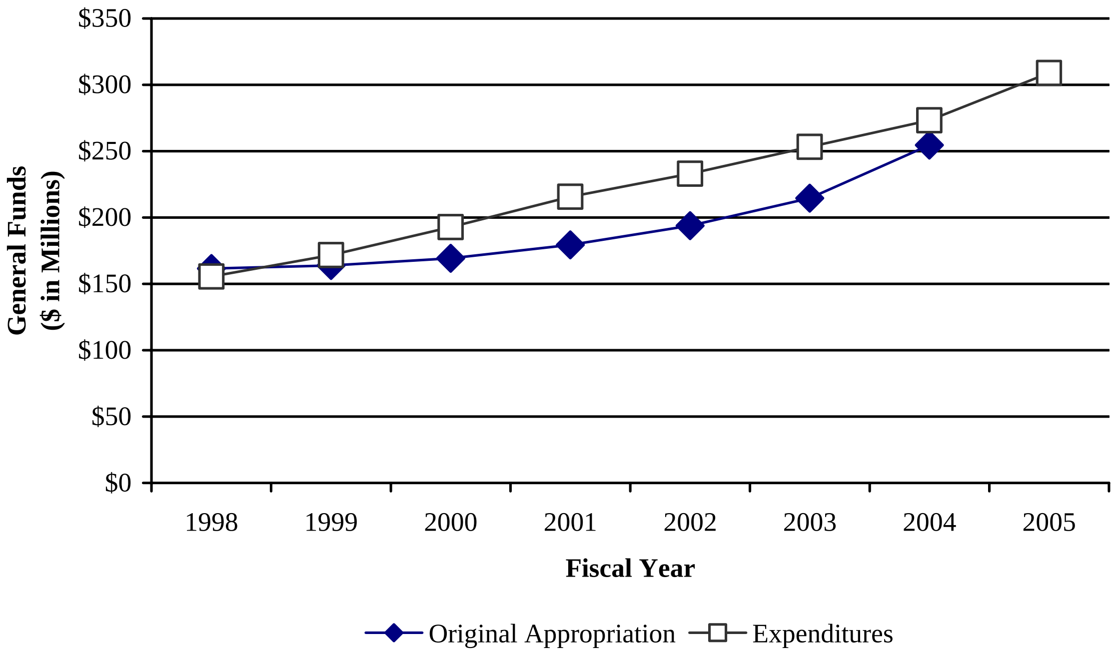
Background

Beginning in fiscal 1998, specialty mental health services were carved out of the Medicaid program and provided largely through a fee-for-service system. Specialty mental health services are defined using accepted diagnostic criteria and provided in a variety of settings including private doctors' offices, outpatient mental health clinics, psychiatric rehabilitation programs, and hospitals. Specialty mental health services are available to Medicaid clients and also to non-Medicaid-eligible clients with incomes up to 116 percent of Federal Poverty Guidelines (for example, $10,417 per year for an individual).

The Structural Deficit in Community Services Funding

Since the 2001 session, discussion around the community mental health system has centered on ongoing deficits in the fee-for-service budget. As shown in **Exhibit 1,** the gap between the available appropriation and actual expenditures first appeared in fiscal 1999. However, because of data reporting issues, it was not until fiscal 2001 that the deficits in the system were recognized. By then, expenditures were 17 percent above the available appropriation. Although the structural gap was significantly reduced in fiscal 2004 because of a significant increase in the appropriation, the gap between expenditures and the appropriation is still estimated at 7 percent, a gap that has widened since the 2003 session due to reductions in the appropriation made by the Board of Public Works (BPW) in July 2003 and increased utilization.

Exhibit 1
The Community Services Structural Deficit
Fiscal 1998 – 2005



Note: Fiscal 2003 through 2005 expenditures are the Department of Legislative Services' estimates. Fiscal 2004 appropriation figure includes reductions made by the Board of Public Works, July 2003.

Source: Department of Legislative Services, Department of Health and Mental Hygiene, and Maryland Health Partners.

In order to close the gap, a variety of actions have been taken:

- In the 2001 session, a Tax Amnesty Program was passed that resulted in $28.5 million being applied to the Mental Health Administration's (MHA) accrued deficits.

- In the 2002 session, the Budget Reconciliation and Financing Act was amended by the legislature to capture over $50 million in higher than anticipated federal disproportionate share payments and directed them to MHA's deficits.

- In the 2003 session, the Governor proposed and the legislature approved a $30 million general fund deficiency appropriation to cover prior year deficits.

However, all these actions have been one-time in nature and in spite of repeated plans detailing cost containment proposals, there is scant evidence that proposals have been implemented or, if implemented, have yielded savings.

Implications for Fiscal 2005

The Department of Legislative Services (DLS) estimates that addressing deficits rolled over into fiscal 2004, closing the structural deficit that exists in fiscal 2004, and providing for growth in fiscal 2005 under the current service delivery system will require as much as an additional $126 million in general funds. Given the State's fiscal problems, finding this amount of additional funding will be extremely difficult.

Absent this cash infusion, the administration will have to consider two alternatives: (1) imposing real and meaningful management controls over the current system; or (2) radically altering the current system by, for example, eliminating the carve-out and requiring managed care organizations to deliver specialty mental health services for Medicaid clients or reverting to a grants and contracts based system of service delivery.

Based on budget reductions taken by BPW in July 2003, MHA appears to have chosen the first path although DLS cautions that the cost containment strategies underpinning those reductions have not proven to be successful in reducing costs. MHA is currently developing additional strategies to preserve the current fee-for-service system while imposing the necessary controls to restrain costs. Details on those strategies are not yet available, but an assessment of their likely effectiveness will clearly be a focus for debate in the 2004 session.

For further information contact: Simon G. Powell Phone: (410) 946/(301) 970-5530

Health and Health Insurance

Solvency of Prince George's Hospital Center and Dimensions Health Care System

Dimensions Health Care System serves a large proportion of uninsured Maryland residents living in the Washington, DC suburbs. Despite numerous task forces, reports, and State and county financial contributions to the operation of facilities in the system, Dimensions is on the brink of financial collapse. The complex relationship between the health system and Prince George's County continues to drive the problems facing the system, and the county and the State currently have different proposals to try and save the system.

History of Dimensions Health Care System

Dimensions plays an important role in providing health care to Prince George's County residents as well as to residents of the Washington, DC metropolitan area, including Southern Maryland. The system faces serious financial difficulties, primarily due to the near-insolvent status of Prince George's Hospital Center (PGHC), a member of the Dimensions system.

Dimensions is a nonprofit health system formed in 1982 to serve residents of Prince George's County and the surrounding area. The system is composed of six member institutions: PGHC, Laurel Regional Hospital, Bowie Health Center, Gladys Spellman Specialty Hospital and Nursing Center, Larkin Chase Nursing and Rehabilitation Center, and Woodward Estate (an assisted-living community). PGHC, the largest provider of emergency services in the county, is a level II trauma center and has 290 licensed beds.

PGHC has a long history of county control, dating back to the 1970 creation of a hospital department within the county government. Although the county has spent the past 20 years moving away from direct management of the hospital, the hospital and the land on which it sits remains under county ownership. In addition, the lease agreement between the county and Dimensions requires a contribution from the county to the health system for indigent care, a contribution that has not been made consistently since the early 1990s.

Uncompensated Care, Physician Costs, and County Control of Land Poses Financial Challenges for Dimensions

The financial problems facing Dimensions stem from a variety of sources, including the competitive health care market in the Washington, DC suburbs, the need to subsidize physician practice groups, a lack of access to capital, and the relationship between the county and the health system. According to a 2002 report prepared by the University of Maryland Medical Systems, PGHC assumes 62 percent of all uncompensated care costs in Prince George's County, and as a system, Dimensions assumes 78 percent of these costs in the county.

In November 2001, the Department of Health and Mental Hygiene (DHMH) issued a report on PGHC's need for a $2.5 million State grant made in the fiscal 2002 budget. The report outlined several factors contributing to PGHC's financial performance and the need for the State's grant including (1) the hospital's disproportionate share of Medicaid and uninsured patients for which PGHC provided more than $26 million in uncompensated care in fiscal 2002; (2) 2.3 percent of the hospital's uncompensated care was not covered by State-determined hospital reimbursement rates; (3) disproportionately high hospital cost inflation; (4) physician subsidies resulting in a $7.1 million annual loss; (5) the Dimensions Health Care System relationship with HMOs and Medicaid managed care organizations cost approximately $7.1 million in fiscal 1999 and 2000; and (6) an unbudgeted $5.4 million increase in nursing costs in fiscal 2001 due to the nursing shortage.

DHMH's report also outlined a long-term plan to restore PGHC's financial stability. The plan includes submitting a full rate review application to the Health Services Cost Review Commission (HSCRC), support from Prince George's County totaling $5.5 million, and more long-term restructuring of PGHC operations with the guidance of Cap Gemini/Ernst and Young, a management consulting firm. The report included a recommendation for an additional commitment of $2.5 million in State funds to be matched by $3 million from Prince George's County. The fiscal 2003 budget included an additional $2 million grant to PGHC contingent upon a $3 million county match.

Legislation enacted in 2002 also established the Prince George's Hospital System Improvement Task Force to identify strategies for the achievement of Dimension's long-term financial stability. The task force was scheduled to terminate at the end of 2004, but its members believed that the dire fiscal condition of Dimensions called for early completion of the task force's final report, which was issued in December 2002.

The task force recommended that the county transfer ownership of PGHC's buildings and land to Dimensions to provide the system with flexibility to restructure its debt and raise capital in the bond market. The task force recommended several other actions for Dimensions and the county to consider in order to assure long-term financial solvency, including (1) requiring the county to resume making its annual indigent care payment to the hospital system; (2) allowing the hospital system to seek county and State assistance with its long-term capital needs; (3) carefully considering any sale or merger options; (4) restructuring Dimensions' board of directors; (5) developing a long-term clinical services plan; (6) strengthening the relationship between the hospital and the State's trauma network; (7) working with HSCRC to develop the right rate structure for the hospitals in the system; and (8) working to enhance the Medicaid fee structure for physicians.

On September 26, 2003, PGHC filed a rate application requesting a temporary rate increase from HSCRC of 10.5 percent to its current rate structure, effective September 1, 2003. The hospital also stated that it would file a full rate application after disposition of the temporary rate request. HSCRC rejected this request, citing concerns about the lack of county financial support and the absence of a viable recovery and restructuring plan. PGHC's subsequent appeal to circuit court was unsuccessful. During this period, Dimensions learned that without the immediate infusion of operating funds, it faced receiving a "going concern" letter from its auditors, which could potentially trigger a default on its $80 million in bonds.

In an effort to stabilize the deteriorating fiscal condition of PGHC, the State assembled an action plan for the hospital in early October 2003. The State proposed raising the hospital rates so Dimensions could raise an additional $10 million during fiscal 2004, provided the county contributes $5 million cash directly to the hospital. The offer of State support is contingent upon the creation of an oversight committee comprised of county and State officials appointed by the Governor. This steering committee would be responsible for retaining an outside hospital "turn around" consultant. All financial and management recommendations made by the consultant would be evaluated by Dimensions' board of directors. The county rejected this proposal, noting the lack of control the county would have over the appointment of the oversight panel. The county has moved forward with a $5 million cash grant to the hospital.

The Future of Dimensions and PGHC

It is clear that the State and Prince George's County must continue to work together to develop meaningful solutions to the current management problems. Given the State's fiscal problems, additional operating dollars for PGHC will be extremely difficult to find, although State subsidies through the capital budget and the hospital rate setting system may be options that are considered for stop-gap State support.

Social Programs

Foster Care Caseload Trends

The foster care caseload is decreasing due to a decline in entries and an increase in adoptions. Despite favorable caseload trends, a fiscal 2004 deficit of about $31 million is likely because the proportion of children eligible for federal funding is declining and the proportion requiring more intensive services is increasing.

The State's foster care and subsidized adoption programs provide temporary and permanent homes for children in need of out-of-home placements due to abuse, neglect, or abandonment. Foster care placements – such as family homes, group homes, and institutions – offer temporary, out-of-home care until achievement of a permanency plan. Permanency options include reunification with the family and adoption. Families that accept legal custody of a child with special needs may receive monthly payments under the subsidized adoption program.

Foster Care and Subsidized Adoption Caseloads

Exhibit 1 shows an anticipated increase of 4.5 percent per year in the combined foster care/subsidized adoption caseload from fiscal 2003 to 2005. The combined increase is the result of a projected increase of 13.3 percent per year in the subsidized adoption caseload, moderated by a 2.6 percent per year decline in the larger foster care caseload. In fiscal 2002, the combined caseload was over 60 percent foster care, but by fiscal 2005, the combined caseload will be evenly divided between foster care and subsidized adoptions.

Foster care caseloads continue a moderate downward trend. Between fiscal 2002 and 2003, Baltimore City and nine counties experienced declines of 5 percent or more in children in paid out-of-home placements. Of the four jurisdictions with the largest caseloads, three experienced a decline in the number of entries into foster care. The Department of Legislative Services (DLS) projects continued moderate declines in the foster care caseload.

Legislation passed in 2001 removed the financial disincentive for foster care families to adopt special needs children. As a result, subsidized adoptions increased dramatically in fiscal 2002 and 2003. DLS projects continued growth in the subsidized adoption caseload.

Funding

Total program costs increased moderately from fiscal 2002 to 2003 and are expected to continue to increase through fiscal 2005. The combined cost per case remains relatively stable over the four years, but that stability masks changes in different components of the caseload.

Exhibit 1
Foster Care Caseloads and Maintenance Payments
Fiscal 2002 – 2005

	FY 2002 Actual	FY 2003 Actual	FY 2004 Estimated	FY 2005 Estimated	Average Annual % Change FY 03 - 05
Caseload					
Foster Care	8,323	8,010	7,805	7,605	-2.6%
Subsidized Adoptions	5,273	5,899	6,683	7,571	13.3%
Total Cases	**13,596**	**13,908**	**14,487**	**15,176**	**4.5%**
Expenditures					
Monthly Cost per Case	$1,414	$1,415	$1,416	$1,426	0.4%
Total Funds ($ in Millions)	**$230.7**	**$236.2**	**$246.2**	**$259.6**	**4.8%**

Source: Department of Human Resources

Cost per case for foster care is increasing, but the caseload is shrinking. Cost per case for subsidized adoptions is stable, and the caseload is growing. The cost of subsidized adoption caseload is small, however, relative to that of foster care. DLS projects that case-mix trends in foster care will continue, i.e., the proportion of higher cost placements, such as group homes and institutions, will continue to increase. Regular foster care continues to be the largest single type of placement but is declining, both in real numbers and as a proportion of the total caseload.

The foster care and subsidized adoption program will likely face a fiscal 2004 general fund deficit of about $31 million. There are three primary reasons for the projected deficit.

- Federal Title IV-E (Foster Care) fund attainment has declined considerably. Title IV-E funds have increased steadily through 2002, but they have not kept pace with the program's total expenditures. The proportion of IV-E-eligible children in the program is declining because eligibility is based on 1995 federal income guidelines. As those income guidelines become more outdated, fewer children will be IV-E-eligible. The fiscal 2004 budget assumed that Title IV-E funds would provide 39 percent of total expenditures in the program; fiscal 2003 actual attainment was 30 percent. The lower-than-anticipated Title IV-E attainment results in an estimated $22 million deficit.

- The fiscal 2004 allowance assumed the availability of $6 million in Medicaid funds, based on the approval of a federal waiver. The federal government has denied the waiver.

- Total expenditures in the fiscal 2004 allowance are likely understated by about $3 million. The cost containment reduction taken by the Board of Public Works further reduces the resources available by $3 million in general funds and an estimated $1 million in federal matching funds. If cost containment actions do not yield the anticipated savings, the total appropriation will be an estimated $7 million below total costs.

For further information contact: M. Kathleen Gardiner Phone: (410) 946/(301) 970-5530

Social Programs

Juvenile Justice Trends

The notion that juveniles that enter the juvenile justice system are to be held accountable for their actions has been a tenet of recent juvenile justice policy. As a result, the number of complaints resolved at intake (i.e., without further intervention from the Department of Juvenile Services) fell dramatically in the late 1990s, while the number of complaints resulting in some form of departmental intervention rose. That trend changed beginning in fiscal 2001 and appears to be continuing. Placements in intensive juvenile services are also increasing.

Complaints and Complaint Resolution

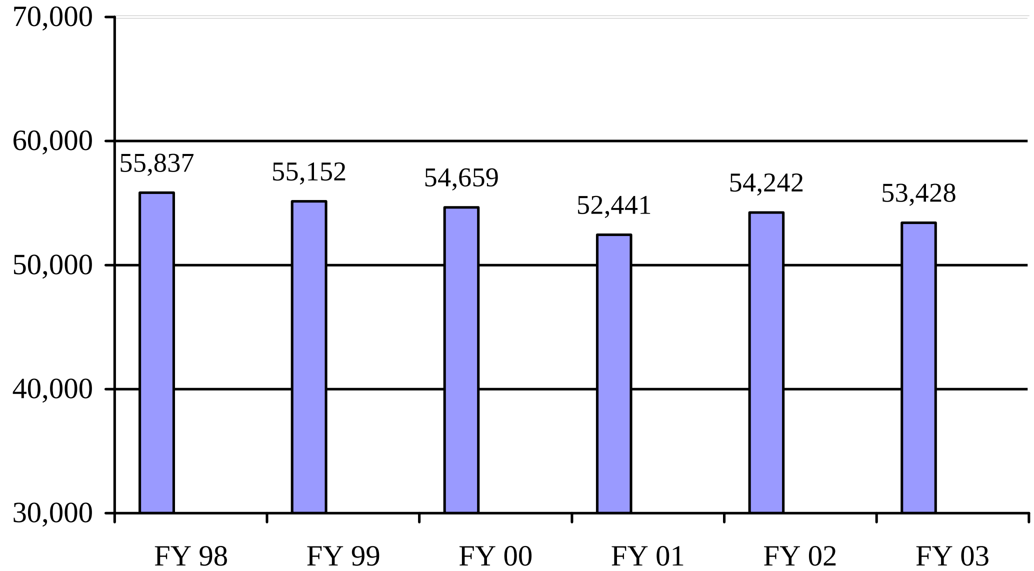
The total number of complaints handled by the Department of Juvenile Services (DJS) broadly mirrors the trend in juvenile arrests. In recent years total juvenile arrests had been falling, albeit slowly. However, beginning in calendar 2000, while the arrest rate continued to fall, the number of arrests appears to bottom out. Similarly, the number of arrests for violent crime has increased since 1999, although the rate of arrests for violent crime is flat. Correspondingly, total complaints handled by DJS, which had been slowly falling, increased in fiscal 2002 before falling slightly (1.5 percent) in fiscal 2003 to a level still above that in fiscal 2001. Fiscal 2003 complaints totaled 53,428 (see **Exhibit 1**).

Exhibit 2 details the trends in complaint disposition at DJS. There are four points to be made from this exhibit:

- Formal caseloads, those complaints determined by an intake officer as requiring formal court action in order to protect the public and ensure offender accountability, show a small increase from fiscal 1998 to 2003, increasing by an average of 2.3 percent per year. However, since fiscal 2000, formal caseloads have been slowly falling. Between fiscal 2002 and 2003, such caseloads fell by 3.9 percent.

- Complaints resolved at intake, those complaints determined by an intake officer to require no further intervention by DJS or the court to protect the public or help the youth, have fallen dramatically in recent years. In fiscal 1997 almost one of every two complaints resolved by DJS was resolved at intake. By fiscal 2000, only one in five complaints was resolved at intake underscoring the notion within the juvenile justice system that actions have consequences. However, beginning in fiscal 2001, the number of cases resolved at intake began to increase. The increase between fiscal 2002 and 2003, 6.7 percent, was less than in the previous year, but nonetheless continues the current trend. While the department has been implementing new risk assessment tools so as to focus on those youth who are most likely to benefit from further intervention, those tools

Exhibit 1
Complaints Received by Department of Juvenile Services
Fiscal 1998 – 2003



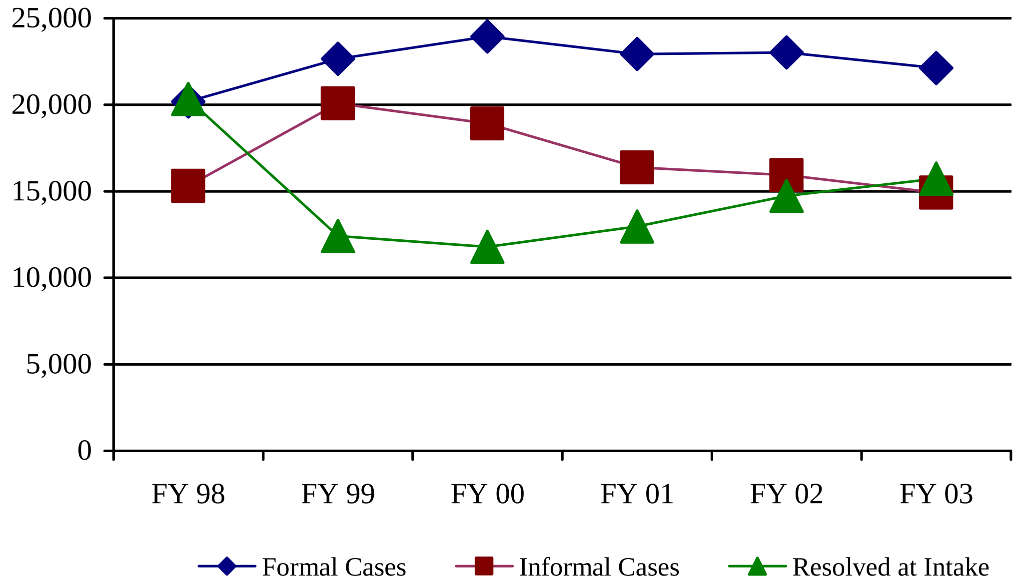
Source: Department of Juvenile Services

have yet to be fully implemented and cannot explain the trend. Other possible explanations include limited community-based intervention resources, a concentration on more serious offenses, and chanes in local police activity.

- The trend in complaints resolved at intake is countered by the trend in complaints resolved through informal supervision. Informal supervision occurs when an intake officer determines that the youth, or the youth's family, is required to seek assistance in preventing further legal violations, but where the youth does not require and/or may not benefit from judicial intervention or long-term formal supervision. Just as complaints resolved at intake have increased in recent years, so informal caseloads have fallen and continued to do so between fiscal 2002 and 2003 (6.3 percent).

- At this time DJS does not know the complaint disposition of 639 complaints received in fiscal 2003, 1.2 percent of total complaints.

Exhibit 2
Department of Juvenile Services Complaint Disposition
Fiscal 1998 – 2003



	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002	FY 2003
Formal Cases	20,183	22,667	23,955	22,928	23,026	22,127
Informal Cases	15,311	20,075	18,912	16,385	15,936	14,931
Resolve/Intake	20,343	12,410	11,792	12,965	14,747	15,731

Note: In fiscal 2001, 2002, and 2003, DJS was not able to confirm the complaint disposition of 163, 533, and 639 complaints respectively. Thus, the sum of the numbers shown in Exhibit 2 for those years does not match the total number of complaints shown in Exhibit 1.

Source: Department of Juvenile Services

Placement Trends

Trends in complaint resolution and arrest rates for more serious crimes continue to point to demand for deep-end (and expensive) programs. As shown in **Exhibit 3**, average daily placement trends through the first quarter of fiscal 2004 show that use of deep-end care has grown steadily since fiscal 2001.

Exhibit 3
DJS Placement Trends (ADP)*
Fiscal 1998 – 2004 YTD

	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004
Secure Detention/ Pending Placement	431	433	460	429	413	464	435
Community Detention/ Electronic Monitoring	459	472	543	436	424	534	578
Shelter Care	92	97	94	83	87	61	66
Committed Care	1,080	1,334	1.452	1,496	1,532	1,444	1,538
Total	**2,062**	**2,336**	**2,549**	**2,444**	**2,546**	**2,503**	**2,617**

*ADP – Average daily population

Source: Department of Legislative Services

Although on an average daily basis total placements are increasing, some interesting trends can be observed in terms of the placement mix:

- The average daily population (ADP) of youth in secure detention or in detention pending placement appears to be falling from the high of fiscal 2003. This fall is primarily due to an increase in the use of electronic monitoring for the pending placement population, something that began in the last months of fiscal 2003 and is correspondingly reflected in the increase in the community detention/electronic monitoring ADP.

- In fiscal 2003 the ADP for committed care fell to its lowest point since fiscal 1999. However, the use of committed care jumped sharply in the first quarter of fiscal 2004 to an ADP of 1,538. This increase is particularly troubling since DJS already faced a gap between its appropriation for committed care and the actual level of expenditures.

Social Programs

Temporary Cash Assistance Caseload and Expenditure Trends

After declining rapidly in the late 1990s, the Temporary Cash Assistance (TCA) caseload has stabilized between 70,000 and 72,000 people. Just under half the current caseload is made up of children or families without an employable adult, making work participation efforts irrelevant for many recipients. The weak economy hinders caseload reduction efforts among those for which employment is possible. With the depletion of previous year balances in federal Temporary Assistance for Needy Families (TANF) funds, State general funds will account for a greater proportion of the spending for Temporary Cash Assistance.

Background

Temporary Cash Assistance (TCA) provides monthly cash grants to needy children and their parents or relative caretakers. The program is funded with general funds, federal Temporary Assistance for Needy Families (TANF) block grant dollars, and certain child support collections.

Caseload Trends

In the early years of welfare reform, efforts to transition individuals from welfare to work and a growing economy led to rapid reductions in the number of TCA recipients. After dropping at rates exceeding 20 percent per year during the late 1990s, the pace of caseload decline has slowed considerably. From fiscal 2002 to 2003, caseload declined 2.3 percent.

The pace of reductions has slowed due to characteristics of the current caseload. Many face multiple barriers to employment, while others, such as child-only cases, may continue to receive assistance regardless of the State's efforts to promote work.

Fiscal 2004 Forecast

The Department of Legislative Services (DLS) estimates an annual average caseload of 71,992 for fiscal 2004, an increase of less than 1 percent. (See **Exhibit 1**.) The projected caseload is 1.5 percent higher than was assumed in the fiscal 2004 budget. As a result, DLS is projecting a fiscal 2004 deficit in the program of $5.1 million. According to the Department of Human Resources (DHR), TANF funds not used in fiscal 2003 are available to cover this deficit, so additional general funds are not needed. Nevertheless, general fund spending is substantially higher in fiscal 2004 than in fiscal 2003 because DHR replaced almost $21 million in general funds with TANF in fiscal 2003.

Exhibit 1
TCA Enrollment and Funding Trends
Fiscal 2003 – 2005

	FY 03 Actual	FY 04 Appropriation	FY 04 Estimate	FY 05 Estimate	% Change FY 04 - 05
Average Monthly Enrollment	71,554	70,904	71,992	70,552	-2.0%
Average Monthly Grant	$145.60	$143.77	$147.49	$148.97	1.0%
Funds ($ in Millions)					
General Funds	9.7	47.0	47.0	56.3	19.8%
Total Funds	**$125.0**	**$122.3**	**$127.4**	**$126.1**	**-1.0%**

Source: Department of Human Resources. Estimates by the Department of Legislative Services.

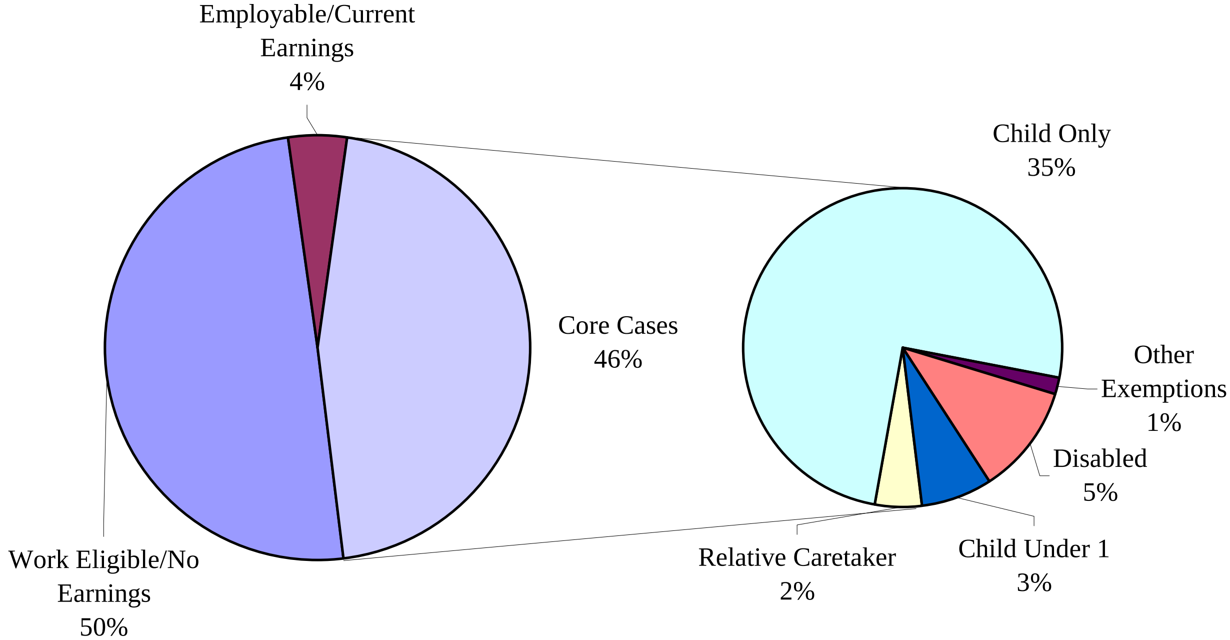
Fiscal 2005

DLS expects the rate of caseload reduction in fiscal 2005 to be consistent with prior years and is estimating a decline of 2 percent. DLS estimates a caseload of 70,552, an average grant amount of $148.97, and total expenditures of $126.1 million. The estimates of average grant and total expenditures reflect the annualized cost of a 1 percent increase in the grant amount in fiscal 2004 and assume another 1 percent increase in October 2004. General funds increase in fiscal 2005 because with the depletion of TANF balances from previous years, less federal funding will be available for TCA.

Characteristics of the Current Caseload

To track recipients needing employment services, DHR divides the caseload into two main groups: (1) the "core" caseload; and (2) cases headed by an employable adult. The core cases include child-only cases, women with children under age one, disabled cases, relative caretakers, and other cases exempted from work requirements. With the exception of women with children under age one, the department does not expect the core cases to transition off cash assistance by seeking employment. Child-only cases, for example, typically leave the rolls when the child reaches adulthood. As employable adults have successfully entered the labor market, the core cases have represented an increasing percentage of the total TCA caseload. As shown in **Exhibit 2**, core cases comprised 46 percent of the TCA caseload in July 2003, dipping below the previous year's rate of 49 percent but still up from 37 percent in December 1998.

Exhibit 2
Characteristics of TCA Cases
July 2003



Source: Department of Human Resources

DHR focuses its employment programs on the cases headed by an employable adult. Exhibit 2 shows that these cases represented 54 percent of the total TCA caseload in July 2003. A small percentage of the employable cases currently participate in the labor market but because of insufficient earnings, they continue to receive cash assistance. Most of the remaining employable adults are in work-related activities but not receiving any earnings.

In the early years of welfare reform, DHR concentrated on serving those easiest to place in employment. Through its successful efforts, most of these cases have transitioned from welfare to work. Now, the remaining cases headed by an employable adult typically face multiple barriers to employment such as substance abuse and/or mental health issues, poor work histories, low educational attainment, and limited access to transportation and child care. To realize further caseload reductions, DHR must continue to provide intensive services to help these employable adults enter and remain in the labor force.

Five-year Lifetime Limit on Receipt of Cash Assistance

Moving employable adults to jobs is particularly important in light of the federal lifetime limit placed on receipt of cash assistance. Federal law prohibits cases headed by an adult from receiving TANF-funded cash benefits for more than five cumulative years. However, federal law also provides exemptions to the time limit for “hardship,” as defined by the State. Under this provision, 20 percent of the adult-headed caseload receiving TANF-funded cash assistance from the previous federal fiscal year may continue to receive these benefits beyond five years.

July 2003 was the nineteenth month in which some families had reached the five-year benefit limit. Of the 22,883 cases in that month, 1,081 had received TCA benefits for 60 months or longer. Since this number was below the 20 percent exemption limit of 4,577, no one was removed from the caseload. According to DHR’s projections, the earliest that any recipient would lose benefits because of the time limit is fiscal 2014. Until that time, the department expects to accommodate, under the federal hardship exemption, all families who cooperate with program requirements.

For further information contact: M. Kathleen Gardiner/Lisa A. Daigle Phone: (410) 946/(301) 970-5530

Transportation

Major Changes in the Consolidated Transportation Program

The Maryland Department of Transportation's draft 2004 *Consolidated Transportation Program* lists all capital projects funded in the current fiscal year as well as those planned for the next five years. Projected State funding in the 2004 draft six-year program decreases by 11 percent; federal funding is projected to decrease by 7 percent.

Overview

The Maryland Department of Transportation (MDOT) publishes an annual *Consolidated Transportation Program* (CTP) that lists all capital projects funded in the current fiscal year and those planned for the next five years. **Exhibit 1** compares last year's proposed six-year program with the six-year program contained in the draft 2004 CTP currently under development.

Exhibit 1
Comparison of Proposed Capital Program
($ in Millions)

	2003 – 2008 CTP	2004 – 2009 Draft CTP	Change	Percent Change
State Funds				
Special Funds	$3,688.6	$3,434.8	-$253.8	-7%
Other Funds*	528.5	332.4	-196.1	-37%
Subtotal State Funds	**4,217.2**	**3,767.2**	**-450**	**-11%**
Federal Aid	**3,369.7**	**3,136.7**	**-233**	**-7%**
Total Funds	**$7,586.8**	**$6,903.9**	**-$682.9**	**-9%**

*Other funding includes proceeds from the sale of bonds issued by the Maryland Transportation Authority and the Maryland Economic Development Corporation, customer facility charges collected by the Maryland Aviation Administration, and certain types of federal aid that do not pass through the Transportation Trust Fund. The other funds category has been adjusted to remove spending totaling $139.4 million that is received directly by the Washington Metropolitan Area Transit Authority (WMATA) to fund the extension of the Metrorail system from Addison Road to Largo Town Center. In addition, a total of $473.1 million in federal capital assistance received directly by WMATA to support ongoing capital programs was also removed from the other category of funding.

Source: Maryland Department of Transportation, 2004 Draft CTP

The funding level projected in the 2004 six-year program decreases by approximately $683 million (9 percent) under the six-year capital program funding level in the 2003 CTP. A decrease of approximately 7 percent is seen in special funds due primarily to the transfer from the Transportation Trust Fund to the general fund of $314.9 million. A decrease of nearly 37 percent is seen in other types of funding (including proceeds from the sale of revenue bonds and funding provided by the Maryland Economic Development Corporation) due to the projected completion in fiscal 2005 of major construction projects at the Baltimore-Washington International Airport that relied heavily on these other funding sources.

No major projects have been added to the six-year program; several large projects are expected to conclude during the fiscal 2004 through 2009 period, including the Largo extension on the Metro system (fiscal 2005), conclusion of major spending on the Transportation Emission Reduction Program funded in the Secretary's Office (fiscal 2005), payment of the last installment of construction costs for the original 103-mile Washington Metro system (fiscal 2004), and completion of the Maryland Aviation Administration projects discussed above. Spending changes within the modal administrations result from cash flow adjustments in ongoing activities.

Changes in Federal Aid

Federal aid to Maryland's capital program decreases by approximately $233 million from levels projected in the 2003 through 2008 CTP. The authorization act for federal spending on highway and transit construction in the United States – the Transportation Equity Act for the 21st Century (TEA-21) – was scheduled to expire September 30, 2003; however, legislation was enacted extending the current authorization for five months (until February 2004). Given the uncertainty surrounding reauthorization and the total amount of federal funding that will be made available in the reauthorization legislation, MDOT's assumptions for federal aid levels beyond fiscal 2005 have been conservatively estimated.

For the first time, the Maryland Transit Administration (MTA) is transferring federal funds from the capital program to the operating program for preventive maintenance as allowed under TEA-21. This contributes to a decrease of just over 19 percent in federal aid in MTA's six-year capital budget.

Summary of Major Changes

As in previous capital programs, most of the capital funding is contained in the early years of the program. The draft 2004 CTP proposes funding totaling $1.9 billion in fiscal 2004 and nearly $1.6 billion in fiscal 2005. The total capital program shows an average annual decrease of approximately 14.8 percent, falling to a low of $856.5 million in fiscal 2009.

As shown in **Exhibit 2**, projects totaling $206.0 million have been added to the 2004 CTP. Of that amount, eight projects at a cost of $180.3 million were added to the construction program while three projects worth $25.7 million were added to the development and engineering program. A total of $21.1 million was added to the capital program to support the study of the proposed InterCounty Connector and to fund right-of-way purchases.

Exhibit 2
Major Changes in the 2004 *Consolidated Transportation Program*
($ in Millions)

Projects Added to the Construction Program

	Project Description	Total Cost
MTA	Metro Fire and Security Management Systems	$68.7
MTA	MARC efficiency improvements	$61.6
MTA	Metro operations facilities	$14.9
MTA	Odenton MARC station improvements	$5.8
SHA	MD 70, Rowe Blvd., replace bridges over Weems and College Creeks (Anne Arundel)	$21.8
SHA	MD 36, George's Creek Road, replace bridge over George's Creek (Allegany)	$3.0
SHA	MD 16, Taylor's Island Road, replace bridge over Parsons Creek (Dorchester)	$2.5
SHA	MD 165, Baldwin Mill Road, replace bridge over West Branch (Harford)	$2.0
Total		**$180.3**

Projects Added to the Development and Engineering Phase

	Project Description	Total Cost
MAA	Runway safety area at BWI Airport	$4.0
SHA	InterCounty Connector Study (Prince George's)	$21.1
SHA	US 220, McMullen Highway, I-68 to the West Virginia Line via MD 53 (Allegany)	$0.6
Total		**$25.7**

Construction Schedule Delays

	Description	Comment	Fiscal Year
MAA	Full build-out of parking guidance system in hourly parking garage at BWI	Delayed due to procurement issues	2003 to 2004
MAA	New air traffic control tower for Martin State Airport	Delayed due to further coordination with the FAA	2003 to 2004

Exhibit 2 - continued

Construction Schedule Delays

	Description	Comment	Fiscal Year
MAA	People Mover System, Phase I at BWI Airport	Delayed to address scope rephrasing	2003 to 2004
MAA	BWI Environmental Analysis – Airport Land Use Plan	Delayed due to further coordination with the FAA	2004 to 2005
MAA	Hourly Parking Garage Expansion, Phase II at BWI Airport	Delayed to better coincide with parking demand projections	2004 to 2005
MPA	Truck and rail circulation improvements at Dundalk	Delayed due to refinement of scope	2003 to 2004
MPA	Niche Cargo Warehouse, shed 6B at Dundalk	Delayed due to postponement of demolition of shed 3B	2004 to 2005
MTA	Owings Mills Joint Development	Delayed due to land acquisition issues	2004 to 2005
SHA	MD 732, Guilford Road, replace bridge over CSX (Anne Arundel, Howard)	Delayed due to acquisition of right-of-way	2003 to 2004
SHA	MD 212 Relocated, Construction of multi-lane arterial from US 1 to I-95 (Prince George’s)	Delayed due to development of engineering plans	2003 to 2004

Projects Removed from the Construction Schedule

	Project Description	Justification
MPA	Land acquisition program	Moved to minor projects
MTA	MARC Hyattsville station improvements	Unresolved issues with CSX
MTA	Bus Neighborhood Shuttle	Removed due to operating cuts

Projects Removed from the Development and Engineering Program

	Project Description	Justification
MAA	New Terminal Area Fire Station	Removed due to reallocation of funds for other priorities

Key: MPA = Maryland Port Administration
SHA = State Highway Administration
MAA = Maryland Aviation Administration
MTA = Maryland Transit Administration
FAA = Federal Aviation Administration

Source: Maryland Department of Transportation, 2004 – 2009 Draft CTP

Transportation

InterCounty Connector Project Planning Under Way

The InterCounty Connector (ICC) is a proposed highway link between I-270 and I-95/US 1. After three years of inaction on the ICC project, the Administration has pledged to "put shovels in the ground" by 2006. However, financing the $1.7 billion cost and addressing environmental issues and community impacts may delay construction.

Project Description

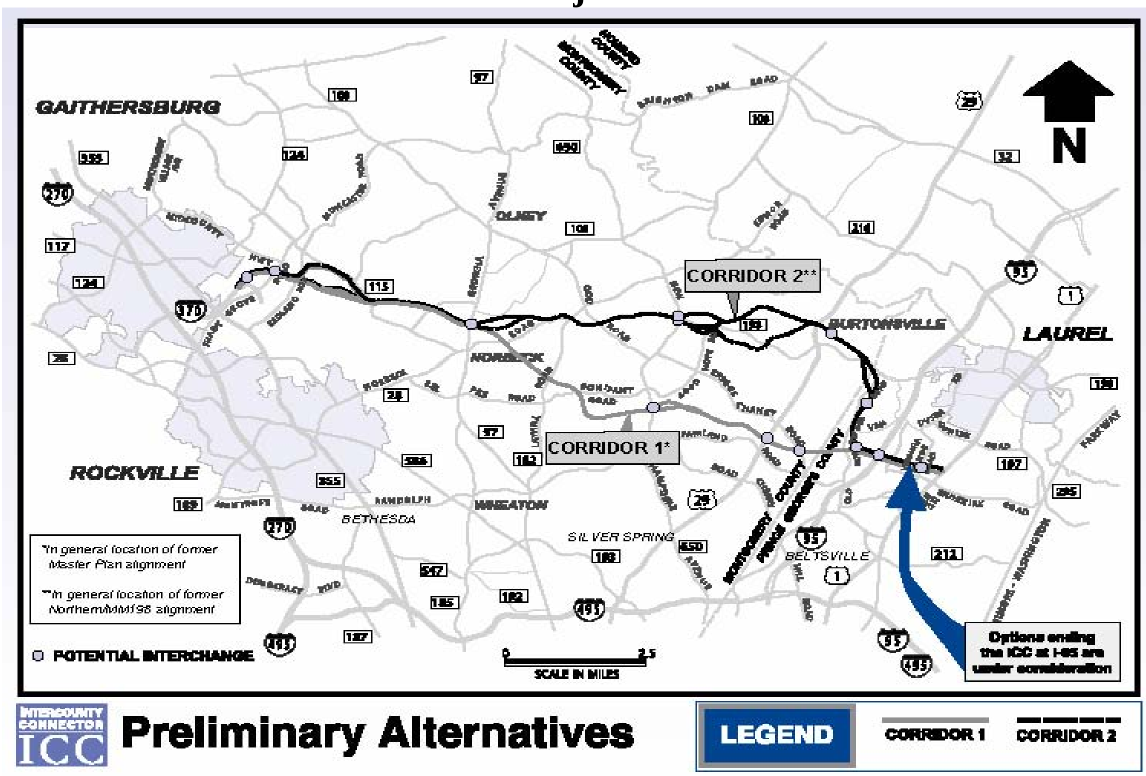
The InterCounty Connector (ICC) is a proposed east-west, limited-access road that would connect I-270 in Montgomery County and I-95/US1 in Prince George's County. The State Highway Administration (SHA) is anticipating an 18-mile, six-lane (three lanes in each direction) parkway design. The proposed alignment of the road runs approximately five to eight miles north of the Capital Beltway (I-695). Estimates as to the expected usage of the new road are still being developed; however, SHA indicates that the new road will accommodate approximately 2,100 cars per lane per hour. **Exhibit 1** provides a map of the area under consideration. The section noted as "master plan" is the alignment identified by the Montgomery County Master Plan.

Current Status of the ICC

The Maryland Department of Transportation (MDOT) began project planning in March 2003 (after a hiatus since September 1999) using existing resources to evaluate the following alternatives: no build, master plan alignment (as identified by the Montgomery County Council), northern alternatives, or to upgrade existing roads. MDOT advises that all alternatives included high-occupancy vehicle lanes and transit accommodations. MDOT is also considering tolls as a means to partially fund the new highway infrastructure.

The State has retained ownership of all land purchased previously. Depending on the alignment chosen, additional land purchases including homes or businesses are possible. The federal National Environmental Policy Act (NEPA) requires detailed planning studies and public hearings prior to construction. Some of the planning studies may not need to be redone due to the short amount of time since the project lapsed. In addition the Bush Administration has selected the ICC for "fast-track" review at the federal level. Instead of sequential reviews of MDOT planning documents by federal agencies such as the U.S. Army Corps of Engineers, the Federal Highway Administration, and the U.S. Environmental Protection Agency, federal agency reviews will be done concurrently. This scheme should expedite the review process.

Exhibit 1
ICC Project Area



Source: Maryland Department of Transportation

ICC Activity	**Fiscal Year**
Project Planning	
NEPA Purpose and Need Statement	Completed July 2003
NEPA Alternatives Identified	January 2004
Draft Environmental Impact Statement hearings	Fall 2004
Final federal record of decision	Spring 2005
Project engineering (in phases)	2004 through 2007
Right-of-way acquisition	2003 through 2007
Construction (in phases)	2006 through 2010

Funding Plans

MDOT expects the cost of the parkway to total $1.7 billion; however, SHA advises that the total cost of the ICC is dependent on the final location and final scope of the chosen alternative. MDOT, SHA, and the Maryland Transportation Authority (MdTA) are continuing to develop a financing plan to fund planning, right-of-way acquisition, and construction of the highway project. Potential funding sources are identified as:

- ***Special Financing Bonds ($900 million to $1.0 billion):*** MDOT and MdTA have the authority to sell special revenue bonds backed by future federal aid receipts, called Grant Anticipation Revenue Vehicles.

- ***MdTA Bonds ($500 to $950 million):*** If the ICC is a tolled-facility, the increased revenue could be used to back revenue bonds sold by the authority. In addition, the increase in total toll revenue to MdTA would increase its own bonding capacity and additional bond proceeds could be raised.

- ***Cash ($50 to $300 million):*** Cash proceeds from the Transportation Trust Fund used on a pay-as-you-go basis could likely support a portion of the project cost.

- ***Additional Federal Revenue ($10 to $50 million):*** Congress will be reauthorizing federal transportation aid within six months. It is possible that additional federal funds could be set-aside for Maryland's use for this project. These funds would be above and beyond the federal transportation aid the State currently receives for highway projects. The Ehrlich Administration has requested this consideration.

The ICC is included in the Administration's draft capital program for the period fiscal 2004 through 2009. In fiscal 2004, SHA anticipates spending approximately $9 million for project planning and $11 million for right-of-way acquisition. Funding in fiscal 2004 will be a mix of State funds and $7 million in federal aid supporting land purchases. Construction funding has not been added to the capital program. Fiscal 2005 spending estimates are not yet available.

Future Challenges for the ICC

Given the other transportation needs in the State, the fiscal status of the Transportation Trust Fund and the State budget, and the high cost to construct this highway, a financing plan for the project will need to be addressed. In addition, the previous Administration pulled this project from its highway program due to environmental concerns over the impact of the project. These concerns still exist, and it remains to be seen how the project plan will mitigate any adverse impact of the highway and its traffic on the environment.

For further information contact: Christine A. Romans Phone: (410) 946/(301) 970-5530

Transportation

Commercial Driver's Licenses

Federal regulations governing commercial driver's licenses (CDLs) were recently adopted to expand the list of motor vehicle violations for which CDL holders are subject to disqualification penalties. The regulations also modify the treatment of a verdict of probation before judgment for a CDL offense subject to disqualification. All states, including Maryland, must implement these changes or face the loss of federal funds.

Background

On July 31, 2002, and January 29, 2003, the federal Motor Carrier Safety Administration published separate final rules to implement the Motor Carrier Safety Improvement Act of 1999. These final rules ensured uniformity among commercial driver's license (CDL) systems in all states. Under the federal rules, all states must implement these changes to CDL licensing and penalty requirements or face the loss of federal highway funds and federal grants from the Motor Carrier Safety Assistance Program (MCSAP). According to the Maryland Department of Transportation, Maryland stands to lose 5 percent of the State's allocation of federal highway funds for the first year in which the State is not in compliance with this federal law; based on data from fiscal 2003, this loss is estimated at approximately $15.4 million. The percentage of lost highway funds rises to 10 percent in the second and subsequent years of noncompliance, which is estimated at approximately $26 million annually. In addition, the State stands to lose approximately $2.3 million annually in MCSAP grant funding.

Disqualifying Offenses for CDLs in Maryland

Currently, the disqualification penalties that the Motor Vehicle Administration may impose on a CDL holder range from disqualification for 60 days to a lifetime disqualification, depending on the offense. These penalties only apply to offenses that occur while driving a commercial vehicle. The offenses that subject a CDL holder to a one-year disqualification include driving under the influence of alcohol or a controlled substance, refusing to take an alcohol test, leaving the scene of an accident, or using a commercial vehicle to commit almost any felony. A CDL holder who carries hazardous materials is subject to a three-year disqualification. Subsequent offenses subject the CDL holder to a lifetime disqualification. A lifetime disqualification penalty is also imposed on a first offense of using a commercial vehicle while committing a felony involving the manufacture, distribution, or dispensation of a controlled dangerous substance. Convictions for various combinations of less severe offenses over various periods of time subject the CDL holder to 60- or 120-day disqualifications.

Anticipated 2004 Legislation

To comply with the final regulations and avoid the loss of federal funds, State laws will need to be amended at the 2004 session to provide that:

- disqualifying offenses include offenses that occur in a non-commercial vehicle;
- driving a commercial vehicle with a revoked, suspended, cancelled, or disqualified CDL as a result of violations committed in a commercial vehicle or causing a fatality through the negligent operation of a commercial vehicle will result in a one-year disqualification for the first conviction and a lifetime disqualification for a subsequent conviction;
- driving a commercial vehicle without obtaining a CDL, driving a commercial vehicle without possessing a CDL, or driving a commercial vehicle of an improper class or with an improper endorsement will result in a 60- or 120-day disqualification; and
- a verdict of probation before judgment for these CDL offenses will be considered a conviction for CDL disqualification purposes.

For further information contact: T. Patrick Tracy Phone: (410) 946/(301) 970-5350

Transportation

Driver's Licenses for Undocumented Immigrants

Access of undocumented immigrants to driver's licenses has become a national issue since the 2001 terrorist attacks. States across the nation have been reexamining their processes for issuing driver's licenses and taking steps to reduce fraudulent use. In Maryland, legislation adopted during the 2003 session created a task force to further explore driver licensing documentation.

Background

The documentation used to obtain driver's licenses has become a controversial issue since the terrorist attacks of September 11, 2001. Before the terrorist attacks, at least 15 states were considering easing immigrant driver's license restrictions. Immigrant advocacy groups had long argued that denial of licenses to immigrants compromised public safety on the highways. Because driving is a necessity to obtain employment in many areas, immigrants drive without licenses. Unlicensed drivers have not demonstrated their knowledge of vehicle laws or their driving competency, increasing the likelihood of accidents. Unlicensed drivers are also unlikely to have auto insurance, increasing claims paid by insurance companies and the premiums paid by licensed and insured drivers.

After the terrorist attacks, as many as 30 states considered measures to restrict immigrant access to driver's licenses. Some of the terrorists were able to gain fraudulent or valid licenses. As a result, many states began reexamining driver licensing documentation procedures. Virginia recently enacted legislation that requires foreign applicants to show proof of legal residence before a driver's license can be issued. The state of Minnesota now issues licenses to immigrants that are a different color than the licenses issued to U.S. citizens.

Other states, however, have expanded immigrant access to driver's licenses. In September, the Governor of California signed Senate Bill 60 into law. The new law makes driver's licenses available to undocumented immigrants by not requiring presentation of a Social Security number (SSN). Applicants without a SSN may obtain a license with a valid birth certificate and one other document, which could be a federal Individual Tax Identification Number (ITIN).

The Maryland Task Force

Maryland is one of the states that considered legislation in 2003 to expand driver's license access to undocumented immigrants. As introduced, House Bill 838 would have specifically prohibited the Motor Vehicle Administration (MVA) from requiring a driver's license applicant to provide information on national origin or immigration status. The bill also would have expanded the types of documents the MVA could accept to verify an applicant's identity, including a foreign government's national identification card, a consular identification card, and a certificate of naming issued by a religious institution, among other documents. To address concerns raised during the bill's consideration, it was amended. As amended, House Bill 838, which became Chapter 452, Acts of 2003, provides that a license applicant must either provide a SSN if he or she has one, or certify that he or she does not have a SSN. The law also strengthens license fraud provisions. Finally, the law establishes a 12-member Joint Task Force to Study Driver Licensing Documentation. The task force is required to:

- study domestic and foreign documentation related to age, identity, and residence;
- assess the extent to which documented immigrants may not receive licenses due to documentation requirements;
- quantify the extent to which individuals without valid licenses actually drive; and
- assess the feasibility of developing processes to verify foreign documentation and to review applications to assess homeland and public safety dangers.

The task force is required to submit its recommendations to the General Assembly by December 1, 2004. The task force was recently appointed; meeting dates have not yet been set.

Attorney General Opinion

The Office of the Attorney General issued an opinion in September on whether the MVA may require individuals with foreign identification to produce proof of legal presence in the United States as a condition of getting a driver's license. The Attorney General concluded that the MVA may require a person without a domestic birth certificate to provide alternate forms of identification, which may include immigration-related documents. However, the inability to verify legal presence in the United States is not, in and of itself, a valid reason for denying a Maryland driver's license.

Driver's Licenses and National Security

Since the 2001 terrorist attacks, the driver's license has become inextricably linked with national security concerns. States and their licensing procedures have been a focal point of concern, although it is the federal government that has sole responsibility for developing immigration standards and enforcing immigration laws. While bills have been introduced to standardize driver's licenses or even create a "national driver's license," at this time, federal law does not preclude issuance of a state driver's license to an undocumented immigrant. States are barred from providing grants, contracts, professional or commercial licenses, and other kinds of benefits to undocumented immigrants, but not driver's licenses. The National Conference of State Legislatures has argued that, rather than trying to preempt state authority to issue driver's licenses, the federal government should put more resources into enforcement of existing immigration laws and be more diligent about deporting those who are found to be in the United States illegally. For example, the Internal Revenue Service recently issued a letter to all state governors asking that the federal ITIN not be regarded as valid identification due to concerns about its fraudulent use.

In the absence of a national identification card, the driver's license has become a convenient way to verify a person's identity. The official purpose of a driver's license is to verify that the licensee is familiar with vehicle laws and is a competent driver. Although it is convenient to use a license to verify legal residence, and as a result, provide the licensee access to commercial aircraft, banking services, and liquor purchases, among other things, many question whether the legal authority exists to use driver's licenses in this manner.

States are continuing to upgrade driver's licenses to help prevent their fraudulent use. Some states have begun using fingerprints and facial scans to verify the identity of license applicants. Maryland has recently completed an upgrade of its driver licensing system and now issues digital licenses with enhanced security features.

Implications for the 2004 Session

Although the task force is not required to issue recommendations until the end of 2004, it is likely that some legislation will be introduced during the 2004 session. Because California has expanded driver's license access to undocumented immigrants, bills may be introduced to emulate the California model or to further restrict access to Maryland licenses. In light of the opinion from the Office of the Attorney General, legislation may be introduced that alters the definition of State residency or further specifies how the MVA may or may not request documents from license applicants that are based on national origin or citizenship status. Comprehensive legislation on driver licensing and documentation is expected for the 2005 session after the task force presents its recommendations to the General Assembly.

For further information contact: Karen D. Morgan Phone: (410) 946/(301) 970-5530

Economic and Community Development

Sunny Day Fund

Since its inception in 1988, 102 projects, including three with multi-year commitments, have received funding from the Sunny Day Fund, for a total commitment of $165.9 million. The number of projects the Department of Business and Economic Development has brought to the Legislative Policy Committee for approval has decreased over the last few years. With only $900,000 in uncommitted funds available, the department anticipates only modifications of several projects in December 2003.

Overview

The Economic Development Opportunities Program (Sunny Day) Fund was created in 1988 to enhance Maryland's competitive position with neighboring states. The Department of Business and Economic Development administers the fund, and expenditures from the fund require the approval of the Legislative Policy Committee (LPC). The fund provides financial incentives in the form of loans, conditional loans, and grants to (1) attract, retain, and expand private sector enterprises in the State; (2) retain and expand existing public institutions, private institutions, or federal research and development institutes; and (3) establish or attract public institutions, private institutions, or federal research and development institutes to the State.

As shown in **Exhibit 1**, LPC has approved conditional grant and loan funds of $165.9 million for 102 projects in 16 different counties from the Sunny Day Fund since its inception. On a regional basis, approximately 79 percent of the projects and 87 percent of the Sunny Day funds have been targeted to the Washington and Baltimore regions.

Exhibit 1
Approved Sunny Day Fund Projects
Fiscal 1990 – 2003

County	Number of Projects	Total Funding
Anne Arundel	9	$17,050,000
Baltimore City	12	16,413,000
Baltimore	17	28,760,000
Caroline	1	800,000
Carroll	3	4,150,000
Cecil	1	2,275,000
Dorchester	1	1,200,000

Exhibit 1 – continued

County	Number of Projects	Total Funding
Frederick	3	7,500,000
Garrett	3	3,850,000
Harford	5	11,250,000
Howard	7	7,872,000
Kent	1	750,000
Montgomery	15	31,925,000
Prince George's	7	15,425,000
Washington	6	8,400,000
Wicomico	2	3,000,000
Statewide/Regional	9	5,300,000
Total	**102**	**$165,920,000**

Note: Although LPC has approved funding for 128 projects, the actual number of projects for which funds have been provided is reduced to 102 due to the withdrawal of 26 projects.

Source: Department of Legislative Services

Exhibit 2 shows the balance of funds currently available in the Sunny Day Fund. Through the first quarter of fiscal 2004 only $900,000 of uncommitted funds is available. Based on anticipated principal and interest payments, it is likely that just $3.1 million will be available to support Sunny Day Fund commitments in fiscal 2004.

Exhibit 2
Maryland Economic Opportunities Fund
(Sunny Day Fund)
($ in Millions)

Beginning FY 2004 Balance	$24.3
Principal and Interest 1st Quarter (Projected total for FY 2004: $3.4 million)	1.2
Operating Expenses for FY 2004	(1.3)
Committed Funds	(23.3)
Total Uncommitted Funds Available (as of October 1, 2003)	**$0.9**

Source: Department of Business and Economic Development

For further information contact: Matthew Klein/Ann Marie Maloney Phone: (410) 946/(301) 970-5530

Economic and Community Development

Heritage Preservation Tax Credit

The Maryland Heritage Rehabilitation Tax Credit program will enter its seventh year of operation in 2004 amid debate over how the program should continue. Property owners seeking to renovate historic buildings can claim the heritage tax credit if the building is either listed on the National Register of Historic Places or is locally designated as a historic property. Nonhistoric buildings that are deemed to be contributing to a historic district or a State-certified heritage area are also eligible. The heritage tax credit is praised as a development tool that can revitalize communities and generate tax revenues and employment. However, the mounting costs of the program have stirred discussions regarding its future, particularly in light of the State's current fiscal condition.

Background

The Maryland Heritage Rehabilitation Tax Credit allows developers and homeowners to receive a tax credit to cover some or all of their costs to rehabilitate a certified heritage structure. Established in 1996, the heritage tax credit has been modified in each legislative session through 2003.[1] Initial modifications resulted in a significant expansion of the credit, making it the State's largest economic development program.[2] However, in 2001, it became increasingly apparent that the State would experience significant revenue losses ($50 to $84 million annually) as a result of these expansions. This revelation led to the enactment of legislation intended to control the State's fiscal exposure.[3]

The State's current fiscal condition will likely prompt a review of the heritage tax credit by the General Assembly in the 2004 session. Moreover, the heritage tax credit will sunset on June 1, 2004, absent enactment of legislation to extend the provisions of the tax credit.

---

[1] Chapter 601 of 1996 established the heritage credit in an amount equal to 10 percent of qualified rehabilitation expenditures for commercial and residential projects. The credit claimed for any taxable year could not exceed the State tax owed for that year; however, excess amounts could be carried forward for ten years. There was no cap on the amount of the credit per project or on the aggregate amount that could be claimed by all taxpayers.

[2] Chapter 731 of 1997 increased the credit to 15 percent; Chapter 735 of 1998 increased the credit to 25 percent; Chapter 667 of 1999 allowed for a choice between receiving an income tax credit or a mortgage credit; Chapters 160 and 161of 2001 allowed residents or businesses using the credit to take the credit as a refund if they have little or no State tax liability rather than carry it over to future years.

[3] Chapter 541 of 2002 reduced the credit to 20 percent and placed a $3 million cap on the amount of credit that may be claimed for any specific project. The legislature also provided for the termination of the heritage tax credit effective June 1, 2004; Chapter 203 of 2003 limited the amount of expenditures for commercial rehabilitations that may be approved between February 1, 2003, and December 31, 2003, to expenditures that, in the aggregate, result in no more than $23 million in credits. In calendar 2004, approved expenditures for commercial rehabilitations were not to exceed $15 million in total tax credits.

Exhibit 1 shows the actual and estimated heritage tax credits using data provided by the Maryland Historical Trust for projects receiving preliminary approvals through the second quarter 2003 report. The estimates assume that approvals have been made against the $23 million aggregate cap for commercial and residential projects for 2003 and against the $15 million projects for commercial projects for 2004. The estimates also assume that there will be no further approvals for commercial rehabilitations beyond 2004. Based on these assumptions, the State will have provided $219.3 million in heritage tax credits through 2009, with a highwater mark of $72.7 million in 2003.

Exhibit 1
Heritage Tax Credit
Actual and Estimated Tax Credits

Calendar Year	Actual Commercial Credit	Estimated Commercial Credit*	Total Commercial Credit	Adjusted Total Commercial Credit**	Residential Credit	Grand Total
1997	$ 196,700	$ 0	$ 196,700	$ 196,700	$ 2,608	$ 199,308
1998	141,284	0	141,284	141,284	161,340	302,623
1999	7,746,845	0	7,746,845	7,746,845	766,300	8,513,146
2000	3,373,394	0	3,373,394	3,373,394	1,509,464	4,882,858
2001	29,988,917	70,000	30,058,917	29,988,917	2,150,239	32,139,156
2002	29,554,840	14,163,039	43,717,879	29,554,840	4,969,015	34,523,856
2003	34,975,281	32,515,477	67,490,758	67,699,242	5,000,000	72,699,242
2004	0	28,994,113	28,994,113	34,320,434	5,000,000	39,320,434
2005	0	8,800,000	8,800,000	14,858,234	0	14,858,234
2006	0	6,250,000	6,250,000	7,015,000	0	7,015,000
2007	0	0	0	1,875,000	0	1,875,000
2008	0	3,000,000	3,000,000	2,100,000	0	2,100,000
2009	0	0	0	900,000	0	900,000
Total	**$105,977,261**	**$93,792,629**	**$199,769,890**	**$199,769,890**	**$19,558,966**	**$219,328,856**

Note: Numbers may not add due to rounding.

*This includes $5 million in each of fiscal 2004 through 2006 representing the $15 million of approvals for commercial projects allowed by Chapter 203 of 2003.

**Adjustments in the timing of credits are made for incomplete 2001 and 2002 projects expected to be completed in 2003.

Source: Department of Legislative Services

Economic Impact

In early 2002, a private consulting firm prepared an economic and fiscal impact study of the heritage tax credit. Using a statistical model to estimate the combined direct, indirect, and induced economic effects of spending resulting from the rehabilitation projects, the consultant study seeks to demonstrate that the State's investment in heritage tax credits produces economic and fiscal benefits that exceed the revenue shortfall incurred by the tax credit.

The study is divided into two sections. The first analyzes the economic and fiscal benefits derived during a typical rehabilitation project with a two-year construction period. The study focused on 247 rehabilitation projects certified by the Maryland Historical Trust and completed in calendar 2000 and 2001. These projects represented $155.5 million of direct rehabilitation expenditures resulting in $38.9 million of heritage tax credits. Based on the consultant's model, these projects created 2,454 jobs throughout the State and stimulated over $261 million of direct, indirect, and induced expenditures. Based on these figures, the consultant report suggests that for each $1 invested in historic tax credits, the State leverages $6.70.

In addition, an estimated $13 million of State sales and income taxes and another $7 million of local income taxes were collected as a result of the economic activity stimulated by the projects. The consultant study, therefore, suggests that 34.2 percent of the State's $38.9 million tax credit investment was recouped through the collection of additional State tax revenues during the two-year construction period alone. The amount recouped during the construction phase increases to 51.4 percent if the incremental local taxes are included. Finally, because the State receives the benefit of the additional tax revenues prior to paying out the tax credit – construction-related economic activity typically takes place for up to two years prior to the distribution of tax credits – the analysis concludes that State and local revenues covered 52.6 percent of the State's tax credit payments before they are made.

The second part of the study attempts to measure the long-term incremental economic and fiscal impact of the heritage tax credit. The report analyzes three commercial redevelopment projects completed during the period covered by the analysis. The analysis first estimates the current value of incremental real property and income tax revenue collected by the State and then calculates the present value of these cash flows. In each of the three cases, the analysis concludes that the net present value of public revenues (the sum of future earnings discounted back to the present) stemming from increased employment and real property assessments measurably outweighed the up-front heritage tax credit investment by the State.

The economic and fiscal benefits claimed to be derived from heritage tax credits are premised on the construction activity not taking place absent the availability of the tax credit. The analysis states that 93 percent of the 40 commercial project tax credit recipients included in the study indicated that their project would not have been completed without the incentive of the State heritage tax credit. The question left unanswered is the level of credit needed to act as an incentive. It is also plausible that absent the heritage tax credit, many of the projects might be undertaken in some other manner. For example, the developer of one of the projects analyzed for future revenue streams reported that he would either undertake the historic rehabilitation or build a completely new facility. Thus, while it may be true that the tax credit made the historic rehabilitation possible, it is also possible that a new building would have been constructed that would have produced similar economic and fiscal benefits as those attributable to the historic rehabilitation.

Finally, the benefit must be weighed against the opportunity cost of providing the heritage tax credit, *i.e.*, the benefit must be weighed against the potential economic and fiscal benefit of alternative uses of the foregone tax revenues. The State could use the tax revenues to support other activities that might provide an economic return on the investment. Other benefits of the heritage tax credit must also be considered, such as targeting development in areas already suited for commercial activity, thus avoiding the cost of providing infrastructure and preserving historic structures that present aesthetic benefits to the community.

Task Force Seeks the Tax Credit's Survival

Facing the potential loss of the tax credit favored by preservationists and developers, Governor Ehrlich appointed a 16-member task force to evaluate the tax credit's effectiveness and determine whether rehabilitation would have occurred in its absence. The task force must also determine whether the tax credit should be continued and in what form and offer recommendations by December 15. The Maryland Historical Trust presented several possible changes to the program to limit its scope, while proposing to extend the expiration date of the tax credit to December 31, 2009. The trust proposed the following steps to keep the program operating:

- impose a $27 million annual cap for the program, of which $20 million would be used for commercial projects exceeding $500,000;
- allow tax credits only for residences with rehabilitation costs less than $200,000 and limit the tax credit to $40,000 per home;
- restrict applications for large commercial projects to three per tax year;
- repeal the refundability of tax credits for large projects with costs over $500,000; and
- alter the review process for large commercial projects to consider geographic location and historical significance and select only the most profitable projects.

The task force recommendations were not finalized at publication time, but the group had made several preliminary decisions – it supported the proposed 2009 expiration date but not the repeal of the credit's refundability.

One of the key elements considered by the task force is whether a cap is needed. Some task force members noted that a cap would be necessary to ensure fiscal predictability, and others commented that it would create uncertainty so that developers would only proceed with projects that would be completed with or without the tax credit. Ultimately, the task force will likely support a $3 million per-project cap for commercial projects; it discussed the possibility of allowing the Board of Public Works to waive this cap under certain instances. It rejected the proposed aggregate cap of $27 million, as well as limits on owner-occupied homes. Another debate centers on whether it should remain a credit or be converted into a grant. Under a grant program, the State can easily forecast the amount of funds that would be required because the amount would be appropriated in the budget and avoid unpredictable fluctuations in revenues. However, proponents of the tax credit observe that grants offer less predictability to developers and more delay for return of the State's investment.

A recurring policy issue raised by the task force is the geographic distribution of the credit (42 percent of the projects awarded the tax credit were in Baltimore City). The city has a significant share of the State's historic housing stock; however, other jurisdictions with historic property have expressed concern that program requirements regarding property value make it difficult for them to compete.

For further information contact: Matthew Klein/Ann Marie Maloney Phone: (410) 946/(301) 970-5530

Business Regulation

Unemployment Insurance

The level of Maryland's Unemployment Insurance Trust Fund is about $176 million below the level that is required to prevent triggering the unemployment surtax on employers, resulting in a 1.1 percent surtax for calendar 2004. The Unemployment Insurance Funding Task Force was established during 2003 to examine the fairness of the existing charging and taxation system and eligibility and benefit provisions and the need to alter the current system to maintain the trust fund at a level sufficient to meet benefit needs. The task force's findings and recommendations are anticipated by the end of December 2003. In addition to legislation that may be introduced by the task force, several prior year bills that increase unemployment insurance benefits or expand the pool of eligible unemployment insurance claimants are likely to be reintroduced in 2004.

Status of the Unemployment Insurance Trust Fund

Under federal law each state must maintain an unemployment insurance trust fund from which unemployment benefits are to be paid. In Maryland, a surtax triggers on the following January 1 when the Maryland Unemployment Insurance Trust Fund balance on September 30 of any year is less than 4.7 percent of the total taxable wages in covered employment for the preceding four calendar quarters. The surtax varies from 0.1 to 2 percent, with the amount depending on the degree to which the trust fund balance is underfunded.

During fiscal 2003 tax revenues amounted to approximately $260 million and benefit payments to approximately $518 million. On September 30, 2003, the balance in the trust fund was $646 million, $176 million below the level that is required to prevent triggering the State's surtax and a significant decrease from last year's $5 million cushion that was over the required level. Since the balance of the trust fund was below the required $822 million, State's employers will be assessed a 1.1 percent surtax in calendar 2004. This translates into an additional cost to employers of $93.50 per employee per year.

Without federal assistance, a surtax of 0.8 percent would have been assessed on the State's employers in calendar 2003. Under the federal Job Creation and Worker Assistance Act of 2002, the federal government distributed $8 billion to the states for unemployment insurance programs. Maryland's share of this "Reed Act" transfer, $142.9 million, was deposited into the State's unemployment insurance account and used to pay benefits during fiscal 2003.

The last year the surtax was assessed was in calendar 1996 (0.6 percent). A surtax was also assessed in calendar 1993, 1994, and 1995 (1.7 percent, 1.7 percent, and 1.1 percent, respectively). Because the trust fund was growing after calendar 1993, legislation was enacted in 1994 and 1995 to bypass the statutory surtax schedule for these calendar years in order to suppress the surtax to a lower percentage than the tables would have required.

Maryland is not unique in having to assess a surtax on its employers for calendar 2004. Many states are assessing surtaxes on their employers for purposes of replenishing their trust funds. Moreover, the economic downturn has significantly impacted seven states that face bankruptcy, forcing them to either seek bailout loans from the federal unemployment insurance trust fund managed through the U.S. Department of Labor (Illinois, California, and New York) or float bonds (Texas). Loans are granted in three-month installments to cover whatever losses are incurred during that period. If the first installment is not paid back by September 30, interest is charged, adding to the cost to taxpayers (through general funds).

Unemployment Insurance Funding Task Force

With the known possibility that the assessment of a surtax on the State's employers was inevitable in the near future, the General Assembly passed Chapter 269 of 2003 to establish the Unemployment Insurance Funding Task Force for the purposes of reviewing Maryland's overall unemployment insurance system. Specifically, the task force is charged with examining the fairness of the existing charging and taxation system under current State law; the fairness of the existing eligibility and benefit provisions under current State law; the need for altering the current system of charging and taxation in order to maintain the Unemployment Insurance Trust Fund at a level sufficient to meet benefit needs; and the impact of changes in the national and State economies and their relationship to changes in the fund. The task force is required to report its findings and recommendations by December 1, 2003. The task force is comprised of legislators, representatives of business and labor, a State agency representative, an economist, and an academic professional.

The task force has held several meetings with discussion focusing mainly on alternatives that impact the taxation system, the noncharging provisions, and benefits and eligibility requirements. The task force's deliberations are likely to continue into mid-December 2003, with a report anticipated by the end of December.

Taxation System

Under current law, monies are paid into the trust fund through a tax on employers paid on the first $8,500 of each employee's annual income (the taxable wage base). The tax is experience rated, with employers with the least turnover paying the minimum tax of 0.3 percent and employers with the highest turnover paying a maximum tax of 7.5 percent. When a surtax is assessed in a calendar year, all employers pay the same surtax percentage.

The task force is considering alternatives that would raise the minimum rate; increase every step of the surtax table by the same amount; raise the maximum rate; raise or index the taxable wage base; experience rate the surtax; create different tax rate tables to be used in different economic climates; or suppress the surtax for 2004.

Noncharging Provisions

The ability of the Maryland unemployment insurance tax structure to provide adequate trust fund reserves to avoid a surtax is affected by several factors relating to the "noncharging" or partial charging of employers for benefits claimed by former employees of those employers. By not charging particular employers for these benefits, the costs are spread to all employers through the trust fund. Noncharging circumstances, also called "leakage," under current law include:

- not charging an employer's account for a former employee's subsequent unemployment after re-employment, particularly where the employee requalifies for benefits after voluntarily quitting the earlier employer (accounts for approximately $57 million);

- the noncharging of closed businesses (accounts for approximately $54 million); and

- the partial charging of businesses with experience ratings (turnover rates) that would theoretically place them at a tax rate greater than the maximum tax rate that can be charged under the State schedule (accounts for approximately $42 million).

The task force is considering alternatives that would charge employers for the unemployment insurance benefits paid that are attributable to the voluntary quit employment; increase the penalty that an employee must serve before being eligible for benefits; require the posting of a security or letter of credit for all employers or new employers; or alter the formula for new employers.

Benefit and Eligibility Requirements

Under current law, benefits range from $25 to $310 per week, with the exact amount based on the claimant's high-quarter wages for the first four of the last five completed calendar quarters, up to maximum qualifying wages of approximately $6,700 in a calendar quarter and approximately $10,080 in a four-quarter period. The maximum weekly benefit (increased from $280 under Chapter 239 of 2002) replaces approximately 43 percent of the State's average weekly wage. The amount of money an individual may earn is $90 while still receiving the full weekly benefit amount. Wages of more than $90 are deducted from a claimant's weekly benefit amount on a dollar-for-dollar basis.

In addition to the weekly unemployment insurance benefits to which a claimant is entitled, a claimant is paid $8 per week for each child, adopted child, or stepchild who is wholly or partly supported by the claimant and under 16 years old, not to exceed five dependents. The unemployment benefit plus the dependents' allowances in any one week may not exceed the highest weekly benefit amount in the schedule of benefits, which is currently $310. Eligible claimants may receive benefits for up to 26 weeks, known as the "uniform method of benefits."

To be eligible, an individual must be (1) able to work; (2) available for work; and (3) actively seeking work. Claimants must be physically able to work at the time the claim is filed and must be available for customary hours of work in his or her occupation. Claimant may not restrict his/her availability to work (*e.g.*, only part-time, limited hours, etc.). Although there is no express requirement that an individual seek "full-time" work, Maryland Court of Appeals decisions have determined that a claimant is not eligible if the claimant restricts his/her ability to work or search for work.

If an individual is released from a job due to a "job abolishment," the individual's weekly benefits are not reduced by a severance amount paid by the employer. However, if the individual is released for other reasons, the individual's benefit is reduced based on the receipt of severance.

The task force is considering alternatives that would alter the base period to be the "most recently completed four quarters" if an individual does not have sufficient wages in the base period to qualify for benefits; change to a "variable duration of benefits"; impose a one-week waiting period for a claimant to receive a first check; extend benefits to certain part-time workers; deduct all severance payments from benefits in all lay off situations; raise the amount of dependents' allowances per child; or eliminate completely dependents' allowances.

Several Failed Measures from 2003 Session Are Likely to Be Reintroduced

Regardless of the forthcoming recommendations of the task force, several 2003 measures aimed at increasing unemployment insurance benefits and expanding the pool of eligible unemployment insurance claimants are likely to be reintroduced.

- House Bill 338 would have increased from $8 to $25 the weekly allowance for each dependent and eliminate the provision that unemployment benefits and this allowance may not exceed in any one week the highest weekly benefit amount in the schedule of benefits. It was estimated that this proposal would have increased trust fund expenditures by approximately $18 million in fiscal 2004.

- House Bill 1171 would have increased the maximum weekly unemployment insurance benefit amount from $310 to $380. It was estimated that this proposal would have increased trust fund expenditures by approximately $20 million in fiscal 2004.

- Senate Bill 251 would have made individuals eligible for unemployment benefits if they were able and available to work only part-time. It was estimated that this proposal would have increased trust fund expenditures by approximately $37 million in fiscal 2004.

- Senate Bill 675 would have provided an alternative base period in determining eligibility for unemployment insurance benefits. Specifically, it would have provided that the most recently completed four quarters of wages paid could be used if the individual was ineligible for benefits using the established formula in the law. It was estimated that this proposal would have increased trust fund expenditures by approximately $76 million in fiscal 2004.

Business Regulation

Horse Racing

Over the past few years Maryland's horse racing industry has undergone many changes but remains in financial trouble.

Despite the elevated interest with the occasional emergence of a humbly-bred winning horse such as Funny Cide, overall, the past several years have seen little change in horse racing across the nation. Live horse racing in the United States has declined in terms of track attendance and wagering at the tracks. Yet, pari-mutual wagering on horse racing has remained steady because of alternative wagering mechanisms including simulcasting, off-track betting, and telephone accounts.

Over the past few years, Maryland's complex and heavily regulated horse racing industry has experienced many changes and challenges. The biggest change sought by the industry – slot machines at racetracks with a portion of the proceeds benefiting racing – failed during the 2003 session. The extent to which slot machines would actually help racing is debatable, but the fact remains that horse racing in Maryland is in trouble.

As detailed in **Exhibit 1**, the number of racing days and purses in Maryland is down, and field size and purses are much greater in Delaware and West Virginia. According to industry experts, the amount of purses determines horse population, which then determines quality of racing. Maryland is plagued by industry infighting between track owners, horse breeders and owners, and horsemen. All horse racing factions agree though that more money is needed for purses and that the best means of increasing purses is to locate slot machines at racing tracks.

State Assistance and Actions Regarding Maryland Racing

Horse racing in Maryland's closest neighbors is succeeding because other forms of gaming, primarily slot machines, enhance purses. Another way to enhance purses includes government grants. In five of the past seven years, the General Assembly authorized the use of State funds to enhance racing purses. Ten million dollars were designated in 1998, 1999, and 2000. In 2001, there was no authorization because of continued industry infighting. In 2002, $3.7 million was given to the industry. In 2003, in anticipation of slot machines, the industry did not pursue other types of State assistance to enhance purses. Even with the State's past contributions to the racing industry, Exhibit 1 shows that purses in Maryland remained much lower than Delaware and West Virginia.

Another reason for the decline in Maryland racing was the condition of its facilities, most notably Pimlico and Laurel Race Tracks. In 2000, the General Assembly established the Racing Facility Redevelopment Program, to assist horse racing facilities with capital improvements.

The assistance was to be provided through a revenue bond fund, funded mostly through increased take-outs from bettors and uncashed winning tickets. To date, no bonds have been issued to finance capital improvements.

Exhibit 1
Purse Supplements for Maryland, Delaware, and West Virginia

	1998	1999	2000	2001	2002
Maryland Racing					
Purse Supplements	$10,000,000	$10,000,000	$10,000,000	0	$3,700,000
Thoroughbred Racing Days	235	236	231	228	226
Standardbred Racing Days	185	187	187	173	177
Delaware Racing					
Purse Supplements	$39,313,700	$51,384,183	$53,688,700	$58,168,600	$62,612,500
West Virginia Racing					
Purse Supplements	Not Available	Not Available	$36,007,713	$48,126,134	$57,428,355

Source: Department of Legislative Services, Maryland Racing Commission Annual Reports, Delaware State Government Web Page, and West Virginia State Government Web Page

During the 2003 session, as part of its revenue enhancement package, the General Assembly required State income tax withholding whenever federal income tax withholding is required for track winnings. It is not a new tax on track winnings; rather it allows imposed withholdings to be offset against winners' tax liabilities. The fiscal impact of the tax is minimal, and the effect on Maryland bettors is "pay the State now, rather than later." Subjecting out-of-state bettors to the immediate withholding, however, could discourage out-of-state residents from wagering at Maryland tracks and off-track betting facilities.

The Industry Has Expanded in Maryland

In spite of the problems facing the industry, there has been some expansion. Currently most thoroughbred racing in Maryland occurs at Pimlico in Baltimore City and Laurel Race Track in Anne Arundel County, both run by the Maryland Jockey Club. All standardbred racing occurs at Rosecroft in Prince George's County and Ocean Downs in Worcester County, which are independently owned. The State Racing Commission licenses each facility, and State law limits the number of licensees. An additional track license was awarded to Allegany Racing in Allegany County, which is owned by the same persons that own Ocean Downs. Allegany Racing has yet to begin construction and most likely will not begin construction until slot machines are approved with Allegany Racing as one of the designated sites.

Ocean Downs has also recently opened an off-track betting establishment in Cambridge, which is located in Dorchester County.

Changing Partners and Rebuilding Efforts in Maryland

During 2002, in an attempt to breathe new energy into Maryland horse racing, the Maryland Jockey Club sold a majority interest to Magna Entertainment Corp, a company with racing interests across the nation. The sale gave Magna control over Pimlico and Laurel racetracks, a training facility in Bowie, and ownership of the Preakness. Magna was expected to bring a much-needed infusion of cash, particularly related to facility improvements. During the 2003 session debate on slot machines, Magna proposed ambitious plans for rebuilding the Pimlico and Laurel racing facilities. These plans were contingent on slot machine revenues, so the plans remain just that. Nevertheless, Magna assured the Racing Commission as part of its approval of the sale, that $15 million would be spent on track improvements. To date, Magna is meeting that obligation and is proceeding with renovations to barn areas, roadways, landscaping, and water and electrical systems.

One issue that surfaced during the 2003 session was Magna's ownership of the Preakness. Legislators were alarmed to learn that Magna actually owned the Preakness and could move the "crown jewel of Maryland racing" out of the State. Officials from Magna have repeatedly assured the General Assembly and public that the Preakness will remain in Maryland.

Despite Magna's assurances the Preakness is intellectual property, the existing laws purporting to protect it are essentially ineffective. The law states that if the Preakness is moved out of the State, the Jockey Club or its successor will forfeit all racing days, live and simulcast, awarded by the commission. Since the Jockey Club owns both major thoroughbred tracks in Maryland and in 2002, 83 percent of racing revenues in Maryland were generated by these tracks, forfeiting these days would clearly further damage racing. In addition, if the Preakness is offered for sale, the State has the right of first refusal. If the owner wants to sell the Preakness, however, it is unlikely the State could come up with the $70 million or so to buy it. Finally, if the Preakness is sold or transferred out of State, takeout allocations and the State racing tax will increase significantly, again, even further damaging Maryland racing. Therefore, because of the way the law is written if the Preakness is moved elsewhere, it could potentially end thoroughbred racing in Maryland.

In September 2002, citing deep financial trouble, the owners of Rosecroft Raceway agreed to sell their beleaguered harness track to Centaur, Inc., which owns several harness tracks and off-track betting facilities in the United States. The closing date for the sale was expected to be November 1, 2003. Centaur anticipated that Rosecroft would be one of the designated slot machine locations. With the failure of the slot machine legislation, Centaur announced that it would partner with Delaware North to assist with the purchase of Rosecroft. Delaware North is a Buffalo-based food concession and entertainment conglomerate that, under a previous name, had a federal court conviction for "conspiring with an organized crime ring to gain control of a Las Vegas casino."

As a result of the revelations regarding Delaware North's past, the Racing Commission, which approved the purchase, started questioning the partnership. Citing concerns over commission approval, Centaur decided to abandon the partnership. Delaware North immediately filed suit to preserve the partnership. After much legal wrangling, both parties parted ways, and Centaur again renewed its efforts to purchase Rosecroft by the November 1 deadline. Centaur failed to gain some concessions from the current owners and missed the November 1 closing date, resulting in the loss of a $2.5 million deposit. Rosecroft could now be for sale once again, and Delaware North as well as other bidders may attempt to purchase the facility.

Saving Maryland Racing

There was an obvious common theme throughout all of the factors affecting Maryland racing during calendar 2003 – slot machine revenues would have been the panacea for the industry's ills. By focusing all of their efforts on the passage of slot machine legislation, industry members made no attempt to secure any other types of assistance.

Besides slot machine revenues, other strategies exist to assist racing. The first strategy is providing government subsidies to enhance purses. A second strategy involves using public authorities to provide financing for the construction of state-of-the-art facilities. Finally, there is a third strategy, which is to let the "free" market determine the outcome of Maryland racing. This strategy involves no State intervention above what already exists, subjecting the industry to the rigors of the marketplace. All of these strategies, including slot machine revenues, are likely to be revisited at the 2004 session.

For further information contact: David A. Smulski Phone: (410) 946/(301) 970-5510

Business Regulation

Retail Electric and Gas Restructuring

Retail electric choice began in Maryland on July 1, 2000, under the Electric Customer Choice and Competition Act of 1999. As competitive markets develop, several issues may come before the General Assembly for further review during the 2004 session. These include (1) the process for providing the standard offer service; (2) the proposal to authorize counties or municipalities to act as aggregators; (3) the proposal to require a renewable portfolio standard; and (4) the impact of suppliers, such as Mirant Corporation, filing for bankruptcy.

Implementation of Electric Restructuring and Standard Offer Service

The Electric Customer Choice and Competition Act of 1999 restructured the electric utility industry in Maryland, introducing "customer choice" of an electric supplier effective July 1, 2000. The electricity industry provides three main services: the *generation* of electricity; the *transmission* of that electricity on high-capacity lines to distribution networks; and the *distribution* of the electricity to customers. Prior to deregulation, the electric utility companies "bundled" these three services and provided them to their customers within their geographically-defined monopoly service territories. Deregulation took the generation component out of this bundled service package.

Two comprehensive mechanisms protect electric customers from rate swings during the transition to electric restructuring: a mandated rate reduction (from 3 to 7.5 percent of base rates as measured on June 30, 1999) and a rate cap through July 30, 2003. However, through 1999 settlement agreements between the utilities and interested parties, alternative rate requirements were negotiated with six utilities. Once price cap requirements expire, wholesale power prices will determine what residential customers pay for electricity.

The resulting system of customer choice allows the customer to purchase electricity generated by other sources and have the electricity delivered over transmission and distribution lines of the local electric utility. However, a customer is not required to purchase electricity from another generator of electricity. The customer has the option to remain with the supplier under the "standard offer service" of the electric company that distributes electricity to the customer.

Under the Act, until July 1, 2003, for investor-owned utilities and July 1, 2005, for cooperatives, each electric company must offer a "standard offer service," at a regulated capped rate, to a customer who (1) does not choose a new electric supplier; (2) has not been offered customer choice; (3) contracts for outside electricity supply that is not delivered; or (4) has been denied service by an electric supplier. After July 1, 2003, if the electricity supply market is not competitive or if the Public Service Commission has not received an acceptable competitive proposal for supplying the standard offer service, the commission is required under the Act to extend the electric companies' current standard offer service obligation, at a bidded market price that is sufficient to provide the electric company with the opportunity to recover verifiable, prudently incurred costs to procure or produce the electricity plus a reasonable return. Despite the Act's July 1, 2003, requirement, each electric company accepted the obligation to provide standard offer service under the terms of its respective 1999 settlement agreement (while rates were frozen or capped).

In carrying out its obligation to determine whether the electricity supply market is competitive, the commission concluded in April 2003 that "a retail electricity market in Maryland has yet to develop to the point that the commission can relieve the utilities of this obligation." About 39 licenses have been granted to suppliers, brokers, aggregators, marketers, and billers of electricity. Nevertheless, the vast majority of electricity sold in the State is produced by conventional central station power plants of the State's four large investor-owned utilities. Only about 4 percent of residential customers and 6 percent of nonresidential customers have switched to an electric supplier other than their distribution company. Accordingly, the commission approved a new settlement (known as "Phase I") that 20 parties collectively filed with the commission setting forth their resolution of how to provide "standard offer service" after utility restructuring rate caps expire.

Specifically, the provisions of the Phase I settlement extend the obligation of the distribution electric companies to provide the "standard offer service;" require these electric companies to report annually to the commission on the wholesale electric supply procurement process and results; and allow the commission to review and approve final bid results, retail prices, and enrollment activity. The electric companies may impose an administrative charge consisting of a utility return component, an incremental costs component, uncollectibles, and an administrative adjustment component. The charge is 4 mills (0.4 cents) per kWh, with 1.5 mills to utilities as return. Residential "standard offer service" offering will be based on an annual procurement of a portfolio of wholesale bids ranging in length from one to three years. In September 2003, the commission concluded a "Phase II" to detail the specific requirements and processes necessary to implement "Phase I."

Exhibit 1 displays the reduction of rates and the timing for the cap or freeze negotiated with six of the utilities that provide in-state electric services and displays the timing for obligation of the investor-owned utilities to provide the "standard offer service" under the 2003 settlement.

Exhibit 1
Electricity Distribution Service (DS) and Standard Offer Service (SOS) Rate Restrictions

BGE (Baltimore Gas and Electric Co.)	Rate Reduction: average 6.5% for *residential* only Rates Frozen for DS and SOS: *residential* through 6/30/06; *commercial* through 6/30/04; and *large industrial* through 6/30/02 SOS Obligation: *residential* through 5/31/10; *commercial* through 5/31/06 or 08; and *large industrial* through 5/31/05 or 06
PEPCO*(Potomac Electric Power Co.)	Rate Reduction: 7% Rates Capped for DS and SOS: *residential* and *commercial* through 6/30/04 SOS Obligation: *residential* through 5/31/08; *commercial* through 5/31/06 or 08; and *large industrial* through 5/31/05 or 06
Connective* (Delmarva Power and Light Co.)	Rate Reduction: 7.5% for *residential* only Rates Frozen for DS and SOS: *residential* through 6/30/04; and *commercial* through 6/30/03 SOS Obligation: *residential* through 5/31/08; *commercial* through 5/31/06 or 08; and *large industrial* through 5/31/05 or 06
Allegheny Power (Potomac Edison Co.)	Rate Reduction: 7% for *residential* only Rates Capped for DS: *residential* and *commercial* through 6/30/04 Rates Capped for SOS: *residential* through 12/31/08; and *commercial* through 12/31/04 SOS Obligation: *residential* through 12/31/12; *commercial* through 5/31/06 or 08; and *large industrial* through 5/31/05 or 06
Southern Maryland Electric Cooperative	Rates Capped for DS: *residential* and *commercial* through 12/31/04; rates then set by commission through 12/31/08 Rates Frozen for SOS: *residential* and *commercial* through 12/31/04; service then offered at market-based prices through 12/31/08
Choptank Electric Cooperative	Rates Capped for DS: *residential* and *commercial* through 6/30/05 Rates Frozen for SOS: *residential* and *commercial* through 12/31/05; service then offered at market-based prices through 12/31/10

*Note: PEPCO and Connective merged in August 2002 to be subsidiaries of PEPCO Holdings, Inc.

Source: Public Service Commission

Aggregation by Counties and Municipalities

Aggregation allows customers to benefit from electric competition by pooling with other customers to negotiate discounted prices. The aggregator is not the supplier but rather a mechanism to allow market-based suppliers to bid on selling electricity to the residential customers whom the aggregated group includes. The commission has licensed several aggregators that are currently targeting business customers with the appeal of saving money on their total energy needs.

Under the 1999 Act, a county or municipal corporation may *not* act as an aggregator for its residents unless the commission determines there is not sufficient competition within the boundaries of the county or municipal corporation. If allowed, the county or municipal corporation could aggregate the retail electric loads of the citizens in their respective jurisdictions and enter into service agreements for the purchase and sale of electricity for the aggregated load pool. Although no jurisdiction is allowed to act as an aggregator at this time, the 1999 Act allows a county or municipal corporation to combine governmental units to purchase electricity for use by the governmental units. For example, a county could form a cooperative that would include its school system buildings and other government buildings. Several counties have taken steps to do this, including Montgomery, Baltimore, Frederick, Carroll, and Anne Arundel. The State has also formed a cooperative to include all State agencies and has invited counties to join that entity.

Senate Bill 37 of 2003 would have repealed the prohibition against a county or municipal corporation acting as an aggregator. The county or municipality would have been able to act as an aggregator to purchase electricity on behalf of its citizens under an opt-in approach (*i.e.*, the government entity chooses the electric provider for a group of citizens who have elected to join the group). Several jurisdictions expressly indicated that they would act as opt-in aggregators, if allowed (College Park, Takoma Park, Greenbelt, Bowie, and Cumberland), and others indicated that they would consider taking on this function.

House Bill 24 of 2003 would have authorized, as a pilot program, Montgomery and Prince George's counties or their municipal corporations to act as an aggregator that purchases electricity on behalf of its citizens under an opt-out approach (a customer would have been deemed to have given permission to the county or municipal corporation to act as its aggregator if, after receiving a notice from the county or municipal corporation, the customer explicitly grants permission by return notice, or if the customer fails to return notice within 30 days of receipt). Ohio and Illinois are the only two states that currently allow opt-out aggregation.

The Senate Finance Committee will be hearing from interested parties on this issue in December 2003. It is anticipated that some form of aggregation legislation will be introduced in 2004.

Renewable Energy Sources and Portfolio Standards

As electric restructuring was being considered, one environmental concern was the potential for increased air pollution and more intensive resource consumption from new generators constructed without demonstrating a need to the commission. Accordingly, the 1999 Act required the commission to prepare a report by February 2000 to address the feasibility of implementing a Renewable Portfolio Standard (RPS) in Maryland.

An RPS requires sellers of electricity to generate a specified portion of electricity from renewable resources or to purchase for resale a sufficient amount of electricity generated from renewable resources. Thirteen states have implemented an RPS program, and two other states have renewable portfolio goals. The report states that the "purpose of implementing an RPS is to permit renewable technologies to overcome the perceived barriers and market imperfections that have impeded effective competition with conventional technologies." A reduction in the emission of pollutants, employment benefits, increased fuel diversity, and resulting increase in energy security could result from an RPS. However, the cost of generating power using renewable energy sources tends to be high, meaning that implementation of such a program would likely increase costs to ratepayers. The commission estimates a cost increase of $.09/kWh to $.21/kWh. Some environmental sources, and promoters of wind power, note that an estimated $.045/kWh price of electricity from that source compares well with recent energy costs for electricity generated from natural gas. Increased volatility in natural gas pricing puts the cost of electricity generated from gas in the range of $.05/kWh.

Legislation aimed at encouraging the use of renewable resources has been introduced during prior sessions, although none of the bills has succeeded. On the basis of interest in the 2003 session, the House Economic Matters Committee has been conducting interim study of renewable energy sources. The issue will likely resurface during the 2004 session.

Filing of Bankruptcy – Mirant Corporation

One of the pillars of electric restructuring under the 1999 Act was the assumption that a robust market in electric generation would be sustained by robust electric suppliers thriving in a newly deregulated environment. The ready availability of venture capital for new generators in the late 1990s fed this assumption. However, in light of the decreasing wholesale cost of electricity in this decade and the fallout from market manipulation in California's deregulated environment, new capital has largely dried up.

Mirant Corporation has been an aggressive participant in deregulated electricity markets. One of the largest electric suppliers in the nation, Mirant is the product of Southern Energy's transformation from a traditional utility to a market trader. Under PEPCO's initial settlement agreement, Mirant purchased all of PEPCO's generation assets, along with contracts relating to the mandated standard offer service in PEPCO's Maryland service territory.

On July 14, 2003, Mirant filed for reorganization under Chapter 11 of the federal bankruptcy code. Among the reasons given, Mirant indicated that it needed to renegotiate the contracts that it had assumed from PEPCO when purchasing its generation assets. The contracts in question required Mirant to provide power to cover PEPCO's obligations for standard offer service and to purchase certain third-party power through PEPCO, at rates that had become less advantageous over time.

The commission and the People's Counsel have each filed pleadings in the federal bankruptcy action and have also filed objections to the contract revocations with Federal Energy Regulatory Commission (FERC). In late October 2003, Mirant and PEPCO reached a settlement on the standard offer service contracts, and presented the preliminary settlement to the bankruptcy court. The commission and the People's Counsel have not objected to the settlement, because it did not require an increase in electricity rates, but only had an impact on revenue sharing. However, the "back-to-back" contracts for purchase of third-party power through PEPCO are unresolved. The commission and the People's Counsel have maintained objections to revocation of these contracts in the federal bankruptcy court, in federal district court, and at FERC.

The primary difficulties raised by the Mirant reorganization are jurisdictional disputes between federal agencies, and so are matters of federal law, not state law. Nevertheless, they will potentially affect any discussion of electric restructuring during the 2004 session by increasing the attention paid to assessing the risk of failure of market participants and the effects of any such failure on the reliability and price of electricity in Maryland.

Business Regulation

Workers' Compensation

The General Assembly created the Workers' Compensation Benefit and Insurance Oversight Committee to review workers' compensation issues and to make recommendations for legislative changes. In the fall of 2003, the oversight committee is reviewing the increasing cost of workers' compensation insurance, the potential impact of the Court of Appeals' decision in the Harris case (*Vernell Harris v. Board of Education of Howard County,* CA No. 43, Sept. Term 2002), the impact of current presumption provisions, and the adequacy of security requirements of self-insured employers.

Rising Cost of Coverage

According to an annual review of manufacturing industry costs by Actuarial and Technical Solutions, Inc., Maryland had the sixteenth lowest workers' compensation premium rates in 2003. Maryland has seen its ranking steadily deteriorate over the past several years from the fifth lowest in 1998. Several states that have remained among the lowest premium states are Arizona, Utah, Oregon, and Virginia.

The National Council on Compensation Insurance, Inc. (NCCI), an independent national rating organization, calculates the component of insurance premium rates that are needed to prefund projected claim loss payments to injured workers. Each year NCCI adjusts, subject to the approval of the Maryland Insurance Administration, the aggregate pure premium rates for Maryland. Based on data from policy years 2000 and 2001, NCCI's November 2003 filing, as approved by the Administration on November 12, 2003, proposes a decrease of 6.1 percent in overall loss costs. This includes a decrease of 7.9 percent based on experience, trend, and benefit data; and a 2 percent increase due to a recent Court of Appeals decision (described below). Prior year filings included the following adjustments: 1.6 percent increase for 2003; 1.3 percent increase for 2002; and 7.6 percent increase for 2001. During calendar 1995 through 2000, there were either no filings (0 percent change) or decreases. NCCI attributes the current decrease to a decline in the frequency of claims. However, NCCI observes that "medical costs continue to increase and that there are signs that indemnity costs will no longer continue in their favorable downward direction."

A recent study by Milliman USA, an independent insurance consulting firm, identifies factors that may contribute to the rising costs of workers' compensation claims. The firm examined the Injured Workers' Insurance Fund's (IWIF) claim experience data and compared it to data collected and analyzed by the Workers' Compensation Research Institute from 12 large workers' compensation states. IWIF's claims experience has relevance to the general experience of all workers' compensation insurance claims in Maryland, because it serves about 35 percent of the Maryland market. One of the significant factors identified as a cost driver was the rate of attorney representation in the determination of permanent partial disability claims, as compared to other states. Another significant factor was the increased cost of medical payments.

Recent Appellate Court Ruling

Until recently, an accidental injury, arising out of and in the course of employment, would not be compensable under the workers' compensation law unless it also arose out of "unusual activity." This precedent set in 1927 was suddenly overturned as a result of a recent Maryland Court of Appeals decision.

The Court of Appeals ruled in June 2003 in the case of *Vernell Harris v. Board of Education of Howard County,* CA No. 43, Sept. Term 2002. In essence, the court found that in order to be compensable, a work-related injury does not have to arise out of an activity that is somehow "unusual." In part, the court noted in its opinion that the "unusual activity" requirement was unique to Maryland, has never been applied consistently, and contravenes the liberal purposes of the workers' compensation law. NCCI, in anticipating an increase in the number of compensable work-related injuries due to the ruling, has projected a 2 percent increase in workers' compensation premium rates. However, NCCI also contends that, in the post-Harris era, there may be fewer disputes and lower attorney involvement which could result in the elimination of some costs and the compensating and settling of some claims at lower amounts.

Critics of the court ruling warn that the impact could be much higher, causing premium rates to increase 5 to 7 percent. While the actual impact of the court ruling remains to be seen, it is anticipated that legislation will be introduced in the 2004 session to support the judicial interpretation, or to negate the decision and clarify the application of an "unusual" test.

Presumptions

Under current law, certain first responders and public safety personnel are presumed to have an occupational disease that was suffered in the line of duty and is compensable if the person has heart disease, hypertension, lung disease, or certain cancers.

In 2003 there were several bills that dealt with presumptions. Baltimore City deputy sheriffs received the benefit of a presumption of compensability (Chapter 107 of 2003) for the occurrence of a new condition, or the worsening of an existing condition, related to heart or lung disease. Other legislation that would have granted the same presumption to Anne Arundel deputy sheriffs failed. Debate continues on the cost of these types of presumptions, who should receive them, and how much lifestyle choices, such as smoking and poor diet impact the onset or worsening of these conditions.

Another type of presumption that may return for legislative action relates to the occurrence of, and compensability for, diseases suffered by emergency responders caused by bloodborne pathogens.

Bankruptcy of Bethlehem Steel Corporation, a Self-insured Employer

Under current law, employers are required to secure workers' compensation coverage or be self-insured. If self-insured, the law requires employers to satisfy to the Workers' Compensation Commission that the employer is financially able to pay compensation and obtain a bond or letter of credit as security.

In June 2003, IWIF outlined in a letter to the Maryland Attorney General the issue of the State paying the ongoing workers' compensation costs for former Bethlehem Steel workers. As a self-insured employer, Bethlehem Steel was required to maintain a $9.2 million bond to cover ongoing costs for workers' compensation claims; however, following the sale of the steelmaker's assets to International Steel Corporation and the assumption of workers' compensation payments by IWIF as the designated third-party administrator, IWIF estimated that outstanding liability may reach as high as $20 million.

Currently, the State's Uninsured Employers Fund (UEF) is statutorily liable for the shortfall, and may have to make a monetary assessment against IWIF, private insurers, and self-insured businesses to recover the UEF's liability. The UEF generates its revenues through an assessment against the workers' compensation industry, but is limited to 1 percent of the workers' compensation awards and an additional 1 percent if the UEF board determines that the reserves of the fund are inadequate to meet anticipated losses. The Attorney General has indicated that it will intervene in the bankruptcy proceedings for the State to become a creditor of Bethlehem Steel and pursue the State's rights before the steelmaker is fully liquidated and all the remaining assets are disbursed.

Workers' Compensation Benefit and Insurance Oversight Committee

The oversight committee held a meeting in October 2003 to hear about the increasing cost of workers' compensation insurance, the potential impact of the Court of Appeals' decision in the Harris case, and the impact of current presumption provisions. At its December 2003 meeting, the oversight committee anticipates hearing more about the increasing cost of workers' compensation insurance; whether changes are needed to the current law to ensure that self-insured employers have adequate security in the event of bankruptcy; and issues relating to IWIF's new payment process and the improvements for the timely receipt of reimbursements by providers for services rendered. It is anticipated that legislation affecting some of the issues the oversight committee is reviewing may be brought to the General Assembly during the 2004 session.

For further information contact: Tami D. Burt/Mitchell J. McCalmon Phone: (410) 946/(301) 970-5530

Business Regulation

Do Not Call Registry

The Federal Trade Commission (FTC) has created the National Do Not Call Registry, which allows consumers to place their names on a single national list in order to stop calls from telemarketers, subject to certain exceptions. The national registry has been the subject of legal challenges that have created confusion among consumers and telemarketers. The U.S. Court of Appeals for the Tenth Circuit has indicated that it will rule that the national registry passes constitutional muster. FTC has urged states, such as Maryland, that have not yet adopted do not call legislation to enact laws that adopt the national registry.

National Do Not Call Registry

In 1994 Congress passed the Telemarketing and Consumer Fraud and Abuse Protection Act, which directed the Federal Trade Commission (FTC) to issue a rule prohibiting abusive and deceptive telemarketing practices and acts. In 1995 FTC adopted a rule that allows consumers to place their phone numbers on the do not call lists of specific companies. In 2003 FTC amended this rule by creating the National Do Not Call Registry, which allows consumers to place their names on a single national list in order to stop calls from all companies that are within the jurisdiction of FTC, subject to certain exceptions. FTC's jurisdiction is substantial, but it does not cover banks, airlines, telecommunication companies, or credit unions.

In 1991 Congress passed the Telephone Consumer Protection Act, which specifically authorized the Federal Communications Commission (FCC) to require the establishment and operation of a national database of telephone numbers of residential subscribers who wish to stop receiving calls from telemarketers. In 1992 FCC adopted a rule implementing the Act but chose to implement a scheme that involved company specific do not call lists rather than a single national database. On June 26, 2003, FCC amended its rule to establish a national registry that includes all telemarketer calls except calls from tax-exempt nonprofit organizations and calls regarding political and religious speech. FCC's rule, unlike FTC's rule, applies to both interstate and intrastate calls. FCC's plan significantly extends the coverage of the national registry and closes the loopholes present under the FTC plan. FCC will implement its plan in conjunction with FTC. FTC will administer the national database, and FTC and FCC will coordinate enforcement with the help of state law enforcement officials.

How the National Do Not Call Registry Works

Consumers may register, free of charge, for the national registry either by phone or online. Consumers who registered with the national registry by August 31, 2003, began to receive fewer telemarketing calls by October 1, 2003. Telemarketers that are covered by the national registry have three months from the date of registration to cease calling consumers who register after September 1, 2003. Generally, after a consumer registers with the national registry, telemarketers must remove the consumer's phone number from their call lists within three months. If a consumer's phone number is listed on the national registry for three months and the consumer receives a call from a telemarketer that the consumer believes is covered by the national registry, the consumer may file a complaint on the national registry's web site. A telemarketer who makes a phone call to a consumer whose phone number is listed on the national registry could be fined up to $11,000 for each call.

Exemptions from the National Do Not Call Registry

It is important to note that the national registry does not cover all telemarketing calls. Even if a consumer's name is listed on the national registry, organizations with which the consumer has an established business relationship may call the consumer for up to 18 months after the consumer's last purchase, payment, or delivery. Organizations to which the consumer has made an inquiry or submitted an application may call the consumer for up to three months. In both cases, if the consumer asks the organization to stop calling the consumer, the organization must honor the consumer's request, regardless of the established business relationship.

In addition, the national registry does not cover calls from political organizations, charities, telephone surveyors, or the business of insurance (to the extent regulated by state law). Again, if a consumer asks the organization to stop calling the consumer, the organization must honor the consumer's request.

Consumers who have placed their phone numbers on the national registry may give written permission to particular organizations by which the consumers wish to be contacted. Consumers who do not place their names on the national registry may nonetheless prohibit particular organizations from calling by asking to be placed on the particular organization's do not call list.

Challenges to the National Do Not Call Registry

The national registry has been the subject of legal challenges that have created confusion among consumers and telemarketers. A federal judge in Oklahoma ruled in September 2003 that FTC does not have the required authorization from Congress to create the registry. In response, Congress quickly passed legislation addressing the issue, and President Bush signed the legislation into law in October 2003. Shortly after Congress passed the legislation, a federal judge in Colorado ruled that the national registry violates the First Amendment of the U.S. Constitution. The September 2003 ruling stated that because calls from charities and telephone surveyors are exempt, the registry discriminates against certain types of commercial speech. The federal judge refused to grant FTC's request to stay the ruling during FTC's appeal. A three-judge panel of the U.S. Court of Appeals for the Tenth Circuit reversed the lower court, lifting the stay and allowing FTC to enforce the registry. The court has not yet ruled on the First Amendment claims, but in its decision to grant the stay, the court stated that there is a "substantial likelihood" that FTC will be able to show that the national registry directly advances the government's "substantial interests" and is "narrowly tailored" and will overcome the First Amendment challenges.

Interaction with State Do Not Call Registries

The federal do not call rules establish a "floor." Thus, states may adopt more restrictive do not call legislation that governs intrastate calls, but any less restrictive state rules are superceded by the federal rules. While FTC rule does not preempt the laws adopted by the states, any state law regulating interstate calls that is different from FCC rule would almost certainly be preempted. Nothing in the federal rules would prohibit a state from enforcing regulations that are consistent with the federal rules in state court.

FTC is encouraging states that have their own do not call lists to adopt the national model and disband their state schemes, thus creating consistency and preventing the states' efforts from being counterproductive to the efforts of the federal government. In addition, FTC has strongly urged states, such as Maryland, that have not yet adopted do not call legislation to enact laws that adopt the national registry, thus allowing state attorneys general to enforce the do not call registry in state courts. If the states do not enact do not call legislation, the state attorneys general will be limited to assisting the federal government's enforcement efforts in the federal courts.

Maryland Proposed Do Not Call Legislation

Bills establishing a Maryland do not call database have been introduced in the General Assembly every session since 1999. None of the bills passed. The 2003 bill would have required the Public Service Commission to establish and provide for the operation of a database that consists of telephone numbers of Maryland residential subscribers who do not wish to receive calls from telemarketers. The bill would have required the commission to update the database every three months and make each update available to telemarketers at a reasonable time prior to the effective date of the update.

The 2003 bill stated that if the federal government established a national do not call database, the commission was required to include information in the national database that related to the information kept in the Maryland database. Under the bill, if the commission found that the federal government had established a program that was in effect and afforded protection equal to or greater than that afforded under the bill, the commission would have been required to report this finding to the Governor and the General Assembly and allow compliance with the federal program to be considered compliance with the requirements of the bill.

Business Regulation

Statewide Living Wage

Living wage laws require employers to pay wages higher than federal or state minimum wages in order to receive contracts or economic development assistance from a local government and are generally set to ensure that a family unit can live without government assistance. Three local jurisdictions in Maryland (Baltimore City, Montgomery County, and Prince George's County) have enacted living wage ordinances. For a jurisdiction that requires a living wage, the benefits of increased tax collections, reduced employee turnover and employer retraining costs, and lowered reliance by working-poor families on government assistance programs can be offset by higher contract costs and potential job losses.

Living Wage Laws

Living wage laws are a policy tool that local governments have used for over a decade. There are three common features in living wage laws. Living wage laws (1) require employers to pay wages that are above federal or state minimum wage levels; (2) are typically linked to definitions of family poverty; and (3) are not intended to cover every worker in a local economy. Some local ordinances also have provisions related to employee benefits such as health insurance and paid vacation. Those usually covered include workers employed by businesses that have a contract with the city or county government or receive economic development subsidies from the local jurisdiction. Living wage laws are currently in force in 105 localities and counties in the United States. There are currently no statewide living wage laws. Wage levels without health benefits range from $6.15 in New Orleans, Louisiana to $13.00 in Fairfax, California.

In Maryland, Baltimore City and Montgomery and Prince George's counties have passed living wage laws. In Baltimore City, Ordinance 442 requires the payment of a living wage set by the Board of Estimates. The hourly wage rate in effect for fiscal 2004 is $8.70. The board revises the living wage level annually. Montgomery and Prince George's counties each have living wage rates set at $10.50.

General Impacts of Living Wage Laws

A Maryland statewide living wage law would impact State procurement in several ways. Issues that relate to a living wage law include effects on (1) costs of contracts and competition; (2) worker productivity and retention; (3) the tax base as it relates to more well-compensated workers and the reliance of Maryland working poor on State and federal assistance payments; and (4) the number of economic development applications.

Contract Costs and Competition

Several studies of the impact of living wage laws conducted in recent years note that contract cost as a percent of total local jurisdiction budgets increased between 0.003 and 0.079 percent or between 0.3 and 2.79 percent of total contract costs for human services contracts. For example, a 1999 Johns Hopkins University study by Christopher Niedt found that for the 26 living wage contracts in Baltimore City that could be compared before and after the living wage law was implemented, the total cost increase to the city was 1.2 percent, less than the rate of inflation at that time.

Some opponents suggest that vendors will be less likely to bid on contracts that have living wage rate requirements. Further, they suggest that a reduction in competition would result. However, there is no empirical evidence available to suggest that living wage laws have directly stifled competition.

Worker Productivity and Retention

Research by Responsible Wealth, United for a Fair Economy, and the Brennan Center for Justice links the low cost increases of contracts in living wage jurisdictions with two main factors. First, several studies note that employers may simply be absorbing the cost of increased wages by lowering profit expectations. Studies also note that employers have to pay less for employee turnover and training because retention rates improve with higher-paying jobs. While hours for lower-paying jobs may decrease and contractors may hire fewer workers, the savings from improved productivity are still positive. These turnover savings mitigate the need for contract cost increases by vendors.

Tax Base and Assistance Payments

Raising wages for contract employees with the State would also have a positive impact on State revenues in the form of higher income taxes. *How Living Wage Laws Affect Low-Wage Workers and Low-Income Families*, a 2002 study authored by the Public Policy Institute of California, indicates that while living wage laws may reduce the size of the low-wage workforce by a small amount, that reduction is offset by the increases in wages for the remaining workers and the reduced costs of employing those workers. The study also reports that urban poverty declines in jurisdictions that enact living wage laws. Increases in income tax collections would be coupled with reductions in payments of child, child care, or earned income tax credits.

In addition to direct tax implications, living wage laws are intended to provide families with an income that removes the need to rely on assistance payments. Reductions in payments through the Temporary Assistance for Needy Families, Medicaid, food stamps, and other programs could provide cost savings not only to workers (as health improves and health care costs decrease) but also to the State (through reduced program costs). There is no quantifiable data or significant study results detailing the impact of living wage laws on reduced government assistance payments or health care costs. In the past two years, the National Policy Association has published both *Income, Socioeconomic Status, and Health: Exploring the Relationships* and *Improving the Health of Working Families: Research Connections Between Work and Health*, which indicate that health care costs and negative health outcomes decline substantially with an increase in family income, especially when the increased income moves the family above the federal poverty level.

Economic Development

Opponents of living wage laws argue that the policy will drive employers away from living wage areas and result in significant job losses. Empirical studies of this effect are not available. Proponents of living wage laws counter with two arguments. The first argument is that local governments are not interested in economic development based solely on minimum wage jobs. The second argument is that the small amount of empirical evidence that does exist suggests that job losses are offset by increased worker retention and tax collections. Data from Minneapolis, San Antonio, Toledo, and Los Angeles suggest that there has not been a decline in applications for local economic development aid in jurisdictions that have enacted living wage ordinances.

Maryland Contract Data and Cost Implications

The Department of Budget and Management (DBM) is the control agency for service contracts in Maryland. DBM is unable to provide specific wage data at an aggregate level. In addition, the Departments of General Services (facilities maintenance, security), Health and Mental Hygiene (direct care providers), and Human Resources (child care, foster care services) do not have aggregate wage data from service contracts. Without specific wage data, it is not possible to articulate realistic cost estimates for implementing living wage laws, or to model the tax implications of raising wages or reducing child, child care, or earned income tax credits. Specific wage data are also needed to estimate reductions in welfare, food stamp, and other assistance payments.

In fiscal 2004, the State appropriated $889 million in total funds for service contracts. **Exhibit 1** shows appropriated funds by service contract category for fiscal 2004. It is unclear how much of those contract costs are wages, and what proportion of those wages would fall below a living wage threshold. For illustrative purposes, if State contract costs mimic the experience in Baltimore City, for each $100 million of current service contract wages, direct contract costs (not adjusted for inflation) could increase by approximately $1.2 million. Adjusting for inflation would mitigate the cost substantially and could even create a savings to the State. Adjusting for increased tax payments and reduction in government assistance program costs would further reduce any direct contract cost increase. There is no reliable method to predict job loss or gain totals due to the implementation of a living wage law, and tax implications could only be estimated with reliable wage data from current contracts.

Exhibit 1
Service Contracts − Statewide Budgeted Funds
Fiscal 2004 Legislative Appropriation

Title	Total Fund	General Fund*	Special Fund*	Federal Fund*
Food Services	$87,213,909	$52,328,345	$17,442,782	$17,442,782
Janitorial Services	30,195,541	18,117,325	6,039,108	6,039,108
Grounds Maintenance	3,330,462	1,998,277	666,092	666,092
Laundry	1,434,487	860,692	286,897	286,897
Housekeeping	14,053,233	8,431,940	2,810,647	2,810,647
Purchase of Care Services**	709,623,328	371,610,624	35,906,159	302,106,545
Security Services	32,436,795	19,462,077	6,487,359	6,487,359
Trash and Garbage Removal	4,747,822	2,848,693	949,564	949,564
Office Assistance	6,435,273	3,861,164	1,287,055	1,287,055
Total	**$889,470,850**	**$479,519,137**	**$71,875,663**	**$338,076,049**

* Fund split estimated as 60/20/20 GF/SF/FF. Purchase of Care Services is actual fund split.
** Developmental Disabilities Administration and Department of Human Resources

Source: Department of Legislative Services

Business Regulation

Special Fund of the Commissioner of Financial Regulation

The Office of the Commissioner of Financial Regulation is primarily a general funded program under the Department of Labor, Licensing, and Regulation. It is anticipated that legislation will be introduced during the 2004 session to make the office special funded and to increase specified fees. Greater financial autonomy may allow the commissioner to address its turnover and salary problems.

Background

The Commissioner of Financial Regulation licenses and provides ongoing regulatory supervision to a wide variety of financial institutions. During fiscal 2003, the different institutions included 67 State-chartered banks, 4 trust companies, 3,813 mortgage companies, 11 State-chartered credit unions, and 2,500 nondepository institutions (consumer loan companies, check cashers, debt collection agencies, and money transmitters).

The commissioner is primarily a general funded program. The commissioner charges fees for various services it provides to the financial industry. All fees go to the general fund, except for the revenue generated by money transmitters, which are included as special funds. **Exhibit 1** shows the revenue collected under the commissioner's authority by source, as compared to the expenditures of the commissioner's office.

Other States' Funding Mechanisms

Exhibit 2 presents fiscal 2001 appropriations and revenues for states in the region. Only three states, Massachusetts, Maryland, and Georgia, are supported with general funds. New Jersey is required to return the unused portion of the total revenues generated by banking regulation to the general fund.

Examiners and Salary Authority

The commissioner's largest task is financial institution examinations. As shown in **Exhibit 3,** for 67 banks, 27 examinations are done jointly with a federal regulator and, therefore, require fewer examiners, and 40 are independent examinations.

Exhibit 1

Fund Split for the Commissioner of Financial Regulation

Revenue Source	FY 2000	FY 2001	FY 2002	FY 2003
Depository Assessments	$3,437,479	$3,552,591	$4,008,062	$4,178,969
Depository Amendments and Filing Fees	48,000	44,000	44,100	44,110
Nondepository Examinations	24,000	92,217	141,492	169,811
Nondepository Investigation Fees	54,200	108,400	98,900	187,300
Nondepository Licensing Fees	3,848,211	962,150	4,193,150	1,557,050
Fines and Penalties	168,232	312,254	941,174	975,000
Miscellaneous Fees	4,144	12,083	0	0
Total Revenue	**$7,584,266**	**$5,083,695**	**$9,426,878**	**$7,112,240**
Expenditures				
Salaries and Benefits	$2,492,045	$3,104,606	$3,686,094	$3,889,211
Technical and Special Fees	85,277	44,319	27,922	4,780
Communication	54,644	35,712	75,984	65,963
Travel/Training	123,369	157,022	148,647	138,805
Lease Expenses, Parking Facilities	14,001	14,650	17,688	17,314
Contractual Services	54,498	34,162	23,191	415,411
E-Licensing (one-time capital expense)	0	0	801,000	0
Supplies and Materials	27,975	38,770	25,494	15,933
Equipment	89,680	165,103	173	7,938
Fixed Charges	98,147	114,335	131,307	165,083
Total Expenditures	**$3,039,636**	**$3,708,679**	**$4,937,500**	**$4,720,438**
Net Difference	**$4,544,630**	**$1,375,016**	**$4,489,378**	**$2,391,802**

Source: Commissioner of Financial Regulation

Exhibit 2
Funding Mechanism for Bank Regulation: Regional States
($ in Millions)

State	FY 2001 Appropriation	FY 2001 Revenues	Net Effect on State General Fund
Connecticut	$15.1	$16.6	0
Delaware	2.4	N/A	N/A
Washington, DC	2.5	1.5	0
Georgia	11.12	15.1	$4.0
Maryland	**3.7**	**5.0**	**1.3**
Massachusetts	10.7	12.5	0.8
New Jersey	7.2	7.2	0
New York	62.4	63.2	0
North Carolina	5.6	N/A	N/A
Pennsylvania	11.8	13.8	0
Virginia	11.6	9.2	0
West Virginia	2.7	2.2	0

Source: Commissioner of Financial Regulation

Exhibit 3
Workload of State Bank Examiners

Type of Exam	Weeks per Exam	Examiners per Exam	Number of Institutions	Required Number of Examiner Weeks
Joint	4	2	27	216
Independent	4	7	40	1,120
Total			**67**	**1,336**

Source: Commissioner of Financial Regulation

According to the Commissioner of Financial Regulation, a fully-trained examiner works about 41.6 weeks a year (62.4 weeks in 18 months). With a full examiner staff of 18, there are about 1,123 examiner weeks available in an 18-month examination cycle. Since completing the current work load within 18 months requires about 1,336 examiner weeks, there is a deficiency of approximately 213 weeks (three examiners) in an 18-month cycle. This shortage means that approximately eight banks are not being examined within the time frame required during each examination cycle.

An examination backlog is also experienced for the over 3,800 mortgage companies. A mortgage company must be examined once every three years and an examination takes about three days. A fully-trained examiner works about 220 days a year (660 days in a three-year period). A fully-trained staff (seven examiners) provide about 4,620 examiner days in a three-year period. Completing the current work load within three years requires about 11,439 days. Consequently, there is a deficiency of about 6,819 days (10 examiners) in a three-year period. This equates to 2,273 firms not being examined over a cycle.

These figures do not include the effects of vacant examiner positions. Over the last four years, the commissioner has had 25 examiner resignations, or about seven a year. The high turnover amplifies the examination backlog. The commissioner attributes most of the turnover problem to low salaries, which are currently established by the Department of Budget and Management. As **Exhibit 4** shows, Maryland has a large work load compared to the number of examiners.

Exhibit 4
Comparison of Institutions and Examiners by State
2002

State	Number of Banks	Number of Bank Examiners	Ratio of Banks Per Examiner	Number of Depository Institutions	Number of Examiners	Ratio of Institutions per Examiner
CT	51	28	1.8	3,500	9	389
DE	18	16	1.1	N/A		
DC	0	3	--	1,515	4	379
GA	260	80	3.3	N/A		
MD	**67**	**18**	**3.7**	**4,553**	**9**	**506**
MA	120	100	1.2	N/A		
NJ	89	39	2.3	N/A		
NY	123	377	.33	2,604	26	100
NC	89	30	3.0	N/A		
PA	164	49	3.3	12,153	13	935
VA	106	43	2.5	N/A		
WV	49	15	3.3	N/A		
Avg.*	**103**	**72**	**1.4**	**4,865**	**12**	**405**

* Average for banks adjusted to omit Washington, DC
Source: Commissioner of Financial Regulation and Department of Legislative Services

Maryland is well below the average number of bank examiners for states in the region (72 versus 18) and well below the average number of examiners per institution. For the states listed, there is an average of 1.4 banks per bank examiner (103 banks and 72 examiners), with New York having the best ratio (.33) and Maryland having the worst ratio (3.7).

As **Exhibit 5** shows, Maryland's bank examiners' salaries are ranked in the lower tier for the region. The data in Exhibit 5 is provided by the Conference of State Bank Supervisors (CSBS). CSBS collects this data once a year from its members. Data for 2003 was not available as of this writing, but it is not expected that the relative ranks of the states has changed much in a year.

Exhibit 5
Salary Comparison of Bank Regulators
2002

State	Financial Examiner: Supervisor I Rank	Financial Examiner III Rank	Financial Examiner II Rank	Financial Examiner I Rank
Connecticut	1	1	2	5
Delaware	10	8	11	13
District of Columbia	N/A	N/A	12	N/A
FDIC	3	3	3	9
Federal Reserve Bank	4	4	1	8
Florida	11	7	4	3
Georgia	9	12	8	6
Maryland	**12**	**13**	**6**	**14**
Massachusetts	13	9	9	10
New Jersey	6	5	5	4
New York	2	2	7	1
North Carolina	5	10	N/A	12
Pennsylvania	7	6	N/A	2
Virginia	8	11	N/A	7
West Virginia	14	14	10	11

Source: Commissioner of Financial Regulation, Conference of State Bank Supervisors

According to the commissioner, the greater financial autonomy a special fund provides (including salary setting authority) would allow the commissioner's office to address the turnover and salary problems.

Fee Schedule

Also, according to the commissioner, various financial regulatory fees set in statute are too low as compared to other states in the region. However, the revenue generated by the commissioner's activities is significantly more than the expenditures, as shown in Exhibit 1.

In response to a request in the *Joint Chairmen's Report*, on December 1, 2002, the commissioner submitted a list of proposed fees. The commissioner proposed to increase 12 current fees and implement 10 new fees. These increases are projected to increase revenues by as much as $8.5 million during a licensing cycle. A sample of those increases is presented in **Exhibit 6**.

Exhibit 6
Commissioner of Financial Regulation: A Sample of Proposed Fee Changes

Application Type	Current Fee	Proposed Fee
New bank charter	$1,500	$15,000
Bank merger or charter conversion	1,500	10,000
Certificate of authority or document copies	1	50
Bank affiliate or subsidiary	0	1,000
Voluntary liquidation	0	3,000
Plan of reorganization	0	3,000
Sales finance company license	250	500
Collection agency license	400	800
Registration of loan officers	0	400

Source: Commissioner of Financial Regulation

Legislation

In the 2003 legislative session, House Bill 1155 was introduced as a departmental bill. This bill would have established a State Financial Regulation Fund in the Office of the Commissioner of Financial Regulation to pay for the direct and indirect expenses in fulfilling the commissioner's duties. This bill would have credited all fees charged by the commissioner that are currently credited to the general fund to the newly established Financial Regulation Fund. The bill would have provided that at the end of each odd-numbered fiscal year beginning June 30, 2007, any unspent portion of the Financial Regulation Fund that exceeds 110 percent of the commissioner's budgeted costs for the following fiscal year would have reverted to the State's general fund. Also, the bill would have increased specified fees and moved the monies in the Money Transmission Fund to the Financial Regulation Fund.

House Bill 1155 was introduced late in the session and was withdrawn before the Rules Committee could act on it. A similar bill, House Bill 1322, was introduced in the 2002 session, and no action was taken on it either.

It is anticipated that the Department of Labor, Licensing, and Regulation will submit legislation again in the 2004 session that will make the commissioner special funded and may include fee increases or a provision for the commissioner to have fee setting authority.

For further information contact: Brian Baugus Phone: (410) 946/(301) 970-5530

Public Safety

Alternatives to Incarceration in Drug Sentencing

Due to increases in prison population growth and budgetary constraints, many states have recently tried to modify their sentencing and release policies, particularly with respect to nonviolent drug offenders. Maryland may be able to benefit from exploring some alternative sentencing policies in order to ease prison burdens and to better address drug dependency within the State's criminal justice system.

National Inmate Population Growth

The latest prisoner survey released by the U.S. Justice Department in July 2003 found that after two years of slowing prison growth, the nation's incarcerated population rose at three times the rate of the previous year. Data from the Bureau of Justice Statistics finds that the national prison and jail population grew by 3.7 percent from 2001 to 2002, compared with 1.2 percent from 2000 to 2001. The 2002 increase amounts to 700 new prisoners being added every week during the year, resulting in a total U.S. inmate population of approximately 2.1 million individuals in 2002.

Despite budget problems, states are still forced to pay the costs of growing prison populations. According to a July 2003 report by the National Conference of State Legislatures (NCSL), 31 states are cutting spending due to state budget shortfalls. Corrections spending are expected to grow by about 1.1 percent in 2004.

Alternative Sentencing Policies

Many states have recently begun making changes in sentencing and release policies in order to limit and control incarceration costs. Several states, including Arizona, Indiana, New Mexico, and Wisconsin, authorized or established sentencing commissions or study groups to examine their sentencing and incarceration policies. Arkansas, Kentucky, Montana, North Dakota, Oklahoma, and Washington released prisoners before their expected release dates in late 2002 or in 2003. Mandatory minimum sentencing for nonviolent offenders is being revisited in many states for budgetary and public policy reasons.

Anecdotal evidence suggests that efforts to establish alternatives to incarceration for nonviolent drug offenders has contributed to limiting inmate population growth in some states. Texas, which recently passed legislation to divert drug offenders to treatment instead of prison, saw a zero inmate population growth rate from 2001 to 2002. Ohio, which in the late 1990s revised sentencing and parole guidelines and created new treatment programs and other alternatives to incarceration, closed a prison in 2002, and its prison growth rate in 2003 was half that of all other midwest states. Various policy models have been or are in the process of being implemented in a number of states.

Presumptive Sentencing (Kansas Model)

Since 1993, Kansas has operated under presumptive sentencing, which is based on the assumption that incarceration is reserved for serious offenders. Uniform sentencing guidelines establish ranges of presumptive sentences proportional to the severity of the crime. Judges may deviate from the guidelines but are subject to appeal on that basis. Maryland has adopted a sentencing guideline system, but judicial compliance is purely voluntary. Revised sentencing guidelines in Kansas provide for treatment sanctions instead of incarceration for drug possession offenders who are determined by the court not to be a public safety risk.

Mandatory Treatment Arizona/California Model

The Arizona approach to drug offenders shifted to mandated treatment rather than incarceration after passage of a 1996 ballot initiative. That initiative imposed a luxury tax on liquor for the program's revenue stream. Half of the revenue goes to the probation departments to cover the cost of drug treatment interventions, and half goes to the Arizona Parents' Commission on Drug Education and Prevention to promote parental involvement in children's education on the risks and health-related problems caused by alcohol and substance abuse. Studies have shown that in Arizona those individuals who complete treatment for drug abuse also are successful in completing probation, while those individuals who do not complete treatment remain in the criminal justice system. The luxury tax on liquor generates about $6.4 million annually, and in fiscal 1999 the net cost avoidance to Arizona with drug treatment programs was $6.7 million.

California adopted a similar initiative requiring most first- or second-time nonviolent offenders to enter treatment programs rather than prison but excludes offenders who prove to be unamenable to treatment. Parolees who violate their parole due to drug possession enter mandatory treatment rather than face additional incarceration.

Staggered Treatment (Willard Program)

Since December 1999, several state criminal justice and drug treatment agencies have collaborated with the Vera Institute of Justice, a sentencing and corrections study and consulting group, to develop the Extended Willard Drug Treatment Program. Operating as a pilot program in two New York City boroughs (the Bronx and Queens), the program diverts from prison those nonviolent, repeat offenders who are substance abusers. Instead, these offenders participate in the 15-month Willard Program − three months in a quasi-military drug treatment campus in upstate New York, followed by six months of residential substance abuse treatment and six months of outpatient treatment. Offenders are under intensive parole supervision during and after the program.

Drug Courts

Drug courts operate in some capacity in every state. Typically, a drug court handles cases involving drug-addicted offenders through an extensive supervision and treatment program. Drug court participants undergo long-term treatment and counseling and are subject to testing, sanctions, incentives, and frequent court appearances. Successful completion of the treatment program results in dismissal of the charges, reduced or set aside sentences, lesser penalties, or a combination of these.

Currently, adult drug courts operate in Baltimore City and Anne Arundel, Harford, and Prince George's counties. Juvenile drug treatment courts currently operate in Baltimore City and Anne Arundel, Baltimore, and Harford counties. Drug treatment courts are planned for Caroline, Cecil, Dorchester, Frederick, Howard, Montgomery, Prince George's, St. Mary's, Talbot, and Wicomico counties. In October 2001, Chief Judge Bell established a Drug Treatment Court Commission with the goal of establishing drug courts throughout the State.

Conclusion

As states continue to struggle with corrections expenses, growing inmate populations, and intractable drug addiction problems, various alternatives to incarceration for nonviolent drug possession offenses are being explored and implemented. Maryland's efforts in the development of drug courts is a recognition of the need for targeted treatment and sanction options for the drug addicted population that enters the criminal justice system. Budgetary and policy efforts to continue drug treatment efforts are likely to continue during the 2004 session.

For further information contact: Guy Cherry Phone: (410) 946/(301) 970-5510

Public Safety

Reconsideration of Sentences

Recent attention has been given to the authority of the court to modify or reduce a criminal sentence at any time after the sentence is originally ordered by the court. A proposal to limit the exercise of that authority within five years following sentencing for violent crimes is before the rules committee of the Court of Appeals. More restrictive limits on the exercise of that authority have been considered by the General Assembly in recent years and may be revisited during the 2004 session.

Background

Judges have the general authority at any time to modify or reduce any criminal sentence that is ordered by the court provided that a timely motion to modify the sentence is filed and certain notice and hearing requirements are followed. Under the Maryland Rule 4-345, a court may revise a sentence if a motion is filed within 90 days after a sentence is imposed. Currently, there is no time limit within which the court may exercise this revisory power.

Under the rule, the State's Attorney must give notice to victims who have requested notification when a motion for reconsideration is filed, when any hearing is scheduled. If a hearing is held, the victim or victim's representative may testify. In addition, the court may modify a sentence only on the record in open court and must ordinarily prepare a statement describing the reasons on which the ruling is based. The court may not increase a sentence, except to correct an evident mistake at the time of original sentencing. The court may also correct an illegal sentence or modify a sentence without a timely motion for modification in the event of fraud, mistake, or irregularity.

Concerns have been raised about this authority in recent years when individuals, whose sentences have been reduced, are released from prison and subsequently commit violent crimes. The most recent instance involved a man who was convicted of the murder of his wife in 1994. In 1999, after the individual received treatment at the Patuxent Institution and after a psychiatrist concluded that he was a low risk to engage in future violent behavior, the sentencing judge reduced his original sentence from 30 to 20 years. As a result, he was eligible for parole and was released in 2001. In 2003, approximately 20 months after his parole, he was arrested for the stabbing death of his girlfriend.

Recent Legislation/Current Developments

In recent years, the General Assembly has considered and rejected legislation that would limit the court's revisory authority. The legislation has included time limitations on the court's power to revise a sentence after a motion has been filed and codification of the rule requirements for (1) victim notification, (2) a hearing on the motion in open court, and (3) a written statement from the court including its reasons for modifying the sentence.

In part due to the recent legislative attention to the issue of the revisory authority of the court, the Maryland Judiciary has examined possible amendments to the revisory power through its rulemaking authority. The Conference of Circuit Judges Ad Hoc Committee to Consider Amending Rule 4-345 has submitted a proposal to the Court of Appeals Standing Committee on Rules of Practice and Procedure that would limit a court's authority to modify or reduce a criminal sentence to instances in which a motion to revise is filed within 90 days in District Court or 30 days in circuit court. In addition, under the proposed amendments, a court may not revise a sentence for a crime of violence more than five years after the sentence was imposed, unless the State's Attorney and the defendant agree. If the rules committee adopts the amendments, which are on the agenda for the committee's meeting on January 9, 2004, the proposal would go to the Court of Appeals for final approval and adoption.

For further information contact: Dea Whayland-Daly Phone: (410) 946/(301) 970-5350

Public Safety

State Correctional Staffing Analysis/Project RESTART

An analysis of State correctional officer staffing requirements by the Department of Public Safety and Correctional Services (DPSCS) determined there was an excess of correctional officers in the Division of Correction (DOC) and the Patuxent Institution. The Administration and the department recently announced a plan, Project RESTART, to reclassify the excess correctional officer positions as part of an effort to enhance the department's existing confinement and security functions with additional substance abuse treatment, job skills training, and counseling services. Despite the positive goals of such a program, there may be fiscal and organizational concerns that could affect the successful implementation of the initiative.

Background

Historically, Maryland's prison system has focused primarily on confinement and control of the inmate population. Funding and resources for rehabilitation and transitional services for the State's inmate population have been limited in recent years, and the results of the State's efforts in the area have been mixed.

According to DPSCS, the State has a prison population of approximately 24,000 inmates. In 2002, approximately 14,600 inmates were released back to the community. The most recent reports on the recidivism rate (the rate at which offenders return to the criminal justice system) indicate that 51 percent of the offenders released by DOC return to criminal justice system within three years.

Staffing Issue and Proposed Project

Recently, DPSCS conducted an internal analysis of its staffing plan for correctional officers which indicates that there are 218 more correctional officers than are necessary in DOC and the Patuxent Institution. It is important to note that these 218 positions do not include correctional supervisors, correctional auxiliary staff (e.g., correctional maintenance, dietary, etc.) or any personnel at the Division of Pretrial Detention and Services (DPDS). Therefore, the department's preliminary staffing numbers may need to be revised in the future.

In November 2003, DPSCS announced an initiative to move the State's corrections policies from a system of confinement and control to a system that focuses on rehabilitation and cognitive restructuring. The initiative, called Project RESTART (Reentry, Enforcement and Services Targeting Addiction, Rehabilitation and Treatment), proposes to enhance existing enforcement with additional substance abuse treatment, job skills training, and counseling services. Under the plan, over a three-year period, DPSCS will add 9,800 new treatment and education programming slots for inmates, including 4,600 slots for adult basic education and general equivalency diplomas, vocational and occupational skills training, employment readiness, and substance abuse treatment. There will also be 5,220 slots each year for a new 12-week behavior modification program addressing conflict management and coping skills in an effort to avoid situations in which a former inmate may re-offend.

The underlying premise of Project RESTART is that by providing support to offenders to address addiction problems, encourage positive behavior modification, and teach skills for success upon returning to the community, subsequent criminal activity and recidivism rates will decrease, the State will save money on incarceration costs, and the offender will become a more productive member of society. To support this position, DPSCS relies on research from Maryland and other states that demonstrates that cognitive restructuring programs that are similar to the features of Project RESTART help reduce recidivism rates.

Through the project, DPSCS plans to reclassify the 218 excess correctional officer positions into 210 cognitive restructuring program and transitional coordinator positions. The department indicates that this will provide the benefit of assessing the programmatic needs of every inmate upon intake, increase the interaction between inmates and case managers, open the proposed 9,800 program slots, and help offenders end the cycle of incarceration and release. The estimated cost of this reclassification is $2 million (which includes $7 million savings by using existing positions). Instead of laying off current employees, DPSCS plans to use the normal attrition over a three-year period to achieve the transition.

Potential Issues with Implementation

Despite the premise and stated goals of Project RESTART as announced by the department and the Administration, there remain a number of unresolved issues regarding the ability of the department to successfully implement this program and to realize the intended goals of these reforms, particularly in light of the continued fiscal challenges facing the State. These issues include:

- **Reliability** – As recently as January 2003, DPSCS indicated that it had developed a report that demonstrated that it was understaffed by 590 correctional officers in DOC and by 67 officers at Patuxent Institution. This finding stands in stark contrast to the more recent findings of the internal staffing evaluation team, which conducted the current audit and found excessive numbers of correctional staff. Given the inaccuracy of earlier estimates, it may be necessary to get independent confirmation of the true expense, security, and programming needs in the facilities. Further, the Office of Legislative Audits (OLA) is conducting an evaluation of the foundation of the previous correctional officer staffing report. The OLA report may act as a barometer of the reliability of DPSCS' current estimates.

- **Operational Plan –** DPSCS has not provided a clear operational plan that addresses the issues of attrition estimates, program personnel allocation, and program space availability. For example, DOC is currently operating at 164.11 percent of the design capacity. This use of non-conventional housing space raises questions about the availability of adequate space to engage in these programs even if the personnel are available. These factors will have a significant impact on the feasibility of any system reform.

- **Cost Estimates –** DPSCS suggests that reclassifying the correctional officer positions into program positions will cost the State $2 million. The primary concern is that in the calculation for right sizing the custody units, DPSCS has not produced estimates of overtime savings.

- **Program Effectiveness** – The studies on which DPSCS relies do not appear to differentiate between cause and effect: did the program convince an offender not to commit additional crimes; or did the offender who decided not to commit additional crimes join the program? Additionally, DPSCS has made no showing that there are enough inmates in the current population that are amenable to treatment to warrant an initiative of this magnitude.

- **Facility Security** – The information that has been presented thus far has lacked an explanation on how fewer correctional officers can provide the same level of security for a growing inmate population.

- **Statewide Fiscal Concerns –** While the cognitive restructuring initiative is laudable and may provide cost savings in the future, funding the initiative will require the Administration and the legislature to divert financial resources from other State priorities.

Impact in the 2004 Session

The results of DPSCS' internal staffing analysis indicates that DOC and the Patuxent Institution are over funded for their current security needs by at least $12 million. As the department begins to move forward in the implementation of Project RESTART, the initiative will require extensive examination from both policy and budgetary standpoints. This "new direction" for the State's correctional system will undoubtedly provide challenges for the General Assembly's review of the budgetary and programmatic needs for the department in the coming years.

For further information contact: William M. Honablew, Jr. Phone: (410) 946/(301) 970-5530

Assault Weapons Ban

Following last year's Washington area sniper attacks and in anticipation of next year's scheduled termination of the 1994 federal assault weapons ban, legislation to ban the sale and possession of assault weapons in the State was proposed during the 2003 session and is likely to be reintroduced in the upcoming legislative session.

1994 Federal Assault Weapons Ban

In 1994, Congress enacted a federal assault weapons ban (Title XI of the Federal Violent Crime Control and Law Enforcement Act of 1994), prohibiting the manufacture, sale, or importation (but not the possession) of specific models of semiautomatic assault weapons or their copies, as well as assault weapons that have a combination of certain military characteristics (such as large capacity ammunition magazines, flash suppressors, pistol grips on a rifle or shotgun, and barrel shrouds to cool gun barrels during multiround firings).

The federal ban also restricts the manufacture and sale of ammunition magazines capable of holding more than 10 rounds (prior to the law, many firearms were sold standard with 30 round magazines). The law exempts assault weapons and large capacity magazines that were manufactured prior to the law's enactment on September 13, 1994.

The federal assault weapons ban is set to terminate on September 13, 2004. Congress has not yet acted on proposed legislation to extend the 1994 enactment. During the 2000 presidential campaign, President George Bush indicated his support for extending the current ban and reiterated that support in 2003. However, the National Rifle Association is opposed to an extension, and some gun control advocates are concerned about securing passage of an extension or related legislation to expand the existing law to prevent the importation of large capacity ammunition clips into the country.

Maryland's Assault Weapon Laws

Assault Pistol Ban/Machine Gun Registration

In 1994, Maryland prohibited the sale and possession of "assault pistols" (defined as 15 specific semiautomatic pistols or their copies). Presumably, the ability to conceal these generally smaller weapons was a factor in prompting this prohibition. The State also maintains a registration system for the possession of machine guns (fully automatic weapons) in the State. However, the lawful possession of a machine gun is extremely limited (for military, law enforcement, or scientific purposes, or as a "curiosity" as long as it cannot be operated as a weapon). Simple possession of a machine gun with either spent or unused ammunition in the "immediate vicinity" is itself a crime.

Assault Weapons as "Regulated Firearms"

The State regulates the possession and sale of assault weapons in the same manner as the possession and sale of handguns, both of which are defined together as "regulated firearms." "Assault weapons" are defined as a list of 45 specific semiautomatic weapons and their copies (mostly types of semiautomatic rifles and shotguns). Before a person purchases, rents, or transfers a regulated firearm in the State, the person must submit to the State Police or other designated law enforcement agency a firearm application that identifies the applicant and the firearm that is the subject of the transaction. Applications are investigated by the State Police and are subject to a seven-day waiting period before the transaction may take place.

An applicant must be at least 21 years old; have never been convicted of a felony, crime of violence, or misdemeanor that carries a penalty of more than two years imprisonment; and must not be addicted to drugs or alcohol or have a history of mental disorder. An applicant is required to complete a certified firearms safety course through the Police Training Commission. An application may be denied by the Secretary of State Police if the Secretary determines that the application contained false information or was not properly completed, or if the Secretary receives notice from a physician that the applicant suffers from a mental disorder and is a danger to the applicant or others.

Proposed State Assault Weapons Ban

Introduced partially in response to the Washington area sniper attacks in the fall of 2002, in which the alleged gunmen reportedly used an assault weapon, Senate Bill 494 and House Bill 844 of 2003 would have prohibited the possession, sale, transfer, or transportation of assault weapons in the State. The bills would have authorized the continued possession of assault weapons possessed prior to the effective dates of the bills if the owners register the weapons with the State Police. The bills also would have authorized the possession of assault weapons by law enforcement personnel, federally licensed firearms dealers or manufacturers who sell to out-of-state dealers, and organizations authorized by federal law to maintain assault weapons as part of their business or activity; and the receipt of assault weapons through inheritance.

Under last year's bills, a violation for possession would have been a misdemeanor subject to imprisonment not exceeding three years or a fine not exceeding $5,000 or both. The use of an assault weapon or magazine with a capacity of more than 20 rounds in the commission of a felony or crime of violence would have been a misdemeanor subject to, for a first violation, imprisonment for not less than five years and not exceeding 20 years. The bills failed, but similar legislation is likely to be reintroduced during the 2004 session.

For further information contact: Jeremy M. McCoy Phone (410) 946/(301) 970-5350

Criminal Law

Death Penalty Developments

Maryland's current death penalty procedures and requirements have been examined and challenged in various ways over the past several years. From a moratorium, to a university study on racial and geographical factors, to pending executions, to numerous court challenges and legislative proposals, the future of the current death penalty procedures in this State remains unclear.

Background

Political and social arguments for and against the use of capital punishment have persisted over many years both nationally and in Maryland. Although questions about the use of the death penalty previously focused on the morality of state-sanctioned killing, more attention is now being paid to the government's ability to administer the system fairly and in a way that minimizes the risk of executing innocent persons. The current debate ranges from concerns about racial, geographic, or socioeconomic inequities to recent questions about procedural requirements relating to the aggravating and mitigating factors weighed in death penalty determinations.

The issues surrounding the death penalty have been in the forefront lately for a number of reasons. In 2002, former Governor Parris Glendening placed a moratorium on executions in the State pending the outcome of a University of Maryland study examining the effects of racial and jurisdictional factors on the imposition of the death penalty in the State. Upon taking office, Governor Robert L. Ehrlich, Jr. lifted the moratorium on executions, and a death warrant was signed for death row inmate Steven Oken shortly thereafter. The execution of Steven Oken was subsequently stayed by the Court of Appeals pending the outcome of his most recent appeal, which was based partially on some recent Supreme Court decisions that have addressed various state sentencing procedures.

In late November 2003, the Court of Appeals upheld Oken's death sentence and the State's death penalty statute, holding that recent Supreme Court cases dealing with the standard of proof in sentencing did not apply to Maryland's death penalty statute. Although it is unclear how this ruling will affect the immediate ability and timing of the court to proceed with new death warrants, this latest court ruling will likely renew the recent debate on the future of the death penalty in Maryland.

University of Maryland Study

Since the death penalty was reinstituted in the State in 1978, there have been three executions in Maryland – two African Americans and one white. Currently, 12 persons are on death row in Maryland, eight of whom are African American.

In the 1990s, the issue of whether there are racial disparities in the implementation of the death penalty in Maryland was considered by various appointed commissions and task forces with no definitive findings. In 2001, funding was provided for a study by the University of Maryland to examine the influence of race (both victim's and offender's) and geography (where the crime occurred and was prosecuted) on the imposition of the death penalty. The study was completed in December of 2002.

The study concluded that there were apparent geographical disparities in the administration of the death penalty, particularly at the stage in death penalty prosecutions in which prosecutors determine whether to issue a notice of intent to seek the death penalty. The likelihood that a death eligible defendant would receive the death penalty is greater if the crime is committed in certain counties. Of the defendants currently on death row, nine committed their crimes and were prosecuted in Baltimore County.

The study also concluded that there appeared to be disparities in the imposition of the death penalty based on the race of the victim. The study found that by itself, the race of the offender did not play a clear role in the processing of death penalty cases at any of the stages of prosecution. However, the study did find evidence of disparity when the race of the victim is considered. If a victim is white, the defendant is significantly more likely to receive a notice of intent to seek the death penalty; however, the study found that when the case actually reaches the penalty phase, the race of the victim does not significantly impact on the imposition of the death penalty.

Finally, the study found that the race of the offender and the victim when viewed together has an impact on the imposition of the death penalty. If an African American offender kills a white victim, he/she is substantially more likely to be charged with a capital offense and, therefore, is at a greater risk of a facing a death sentence.

Recent Federal and State Cases

Apprendi v. New Jersey

A number of recent challenges to the State's death penalty laws have been based on a Supreme Court decision that ironically did not involve a death sentence, but instead dealt with the standard of proof and the trier of fact for enhanced penalties in a New Jersey hate crime statute. In *Apprendi v. New Jersey* 530 U.S. 466 (2000), the Supreme Court found the hate crime statute violated constitutional due process requirements because the statute authorized a trial court to enhance a maximum statutory penalty if the trial judge found by a preponderance of the evidence that the violator acted with the intent to intimidate the victim due to the victim's race, gender, religion, or sexual orientation. The court held that, with the exception of the existence of prior convictions that may carry increased penalties, any fact that is used to increase the severity of a sentence over the maximum statutory length must be submitted to a jury and proved beyond a reasonable doubt, a higher standard of proof than the preponderance of the evidence.

Borchardt v. State

In 2001, the Maryland Court of Appeals decided a death penalty challenge in *Borchardt v. State*, 367 Md. 91 (2001), based on an *Apprendi* argument as to the standard of proof required to find whether aggravating circumstances in a death penalty case outweigh the mitigating circumstances. Under Maryland's death penalty sentencing statute, in order to impose a death penalty, the trier of fact (the court or a jury) must first determine beyond a reasonable doubt that certain aggravating circumstances exist in a first degree murder case, then determine by a preponderance of the evidence whether any mitigating circumstances exist. If mitigating circumstances are found to exist, the trier of fact must then determine by a preponderance of the evidence that the aggravating circumstances outweigh the mitigating circumstances in the case.

In *Borchardt*, the issue was whether the trier of fact could find that the aggravating circumstances outweighed the mitigating circumstances by a preponderance of the evidence or if the due process requirements outlined in *Apprendi* required the use of the higher standard of proof of a finding beyond a reasonable doubt. The Court of Appeals upheld Maryland's death penalty statute in *Borchardt* predominantly on the basis that the weighing of the circumstances in a death penalty case does not "enhance" the maximum sentence of death for first degree murder, and therefore, the holding in *Apprendi* did not overrule Maryland's statutory scheme.

Ring v. Arizona

In June 2002, the Supreme Court decided the death penalty case of *Ring v. Arizona*, 122 S.Ct. 2428 (2002). The court overturned a capital conviction on the basis that a sentencing judge, sitting without a jury, may not find the aggravating circumstances necessary for the imposition of the death penalty. The court found this practice to violate the defendant's constitutional right to a trial by jury because Arizona's aggravating factors operate as "the functional equivalent of an element of a greater offense" and, therefore, must be determined by a jury beyond a reasonable doubt.

Although Maryland requires the determination of the death sentence to be made by the same trier of fact as the determination of guilt and the defendant may elect to be tried by either a judge or a jury (an option that was not available in the case examined under *Ring*), the decision in *Ring* was viewed by some as potentially significant to Maryland's death penalty statute. Subsequent challenges to Maryland's death penalty statute under a *Ring* theory were offered, arguing that the implication of the decision is that, since aggravating circumstances are a "functional equivalent" of element of an increased penalty in death cases, they must be found by a jury to outweigh mitigating circumstances beyond a reasonable doubt. However, the Court of Appeals has recently discounted the *Ring* theory as applied to Maryland's death penalty statute.

Oken v. State

Steven Oken was sentenced to death for the 1987 murder of Dawn Garvin in Baltimore County. After Governor Ehrlich lifted the moratorium on executions in January 2003, Oken was the first inmate for whom a warrant of execution was signed, and he was scheduled to be executed the week of March 17, 2003. The Court of Appeals issued a stay on the warrant pending his appeal challenging the constitutionality of Maryland's death penalty statute in light of the Supreme Court's holding in *Ring*. Oken asserted that the statute is unconstitutional on the basis that aggravating circumstances used in death sentencing must be proved to outweigh mitigating factors beyond a reasonable doubt, rather than by the less onerous standard of proof by the preponderance of the evidence as contained in Maryland's statute.

In November 2003, the Court of Appeals rejected a *Ring* challenge of Maryland's death penalty in *Oken v. State,* No. 117, Sept. Term 2002. In *Oken*, the court held that the weighing process between aggravating and mitigating circumstances under the statute is not a finding of fact based on evidence, but is rather a purely judgmental process of balancing the competing circumstances. The court found significant the distinction between the current statutory requirement of proving the existence of aggravating circumstances beyond a reasonable doubt, and the provisions that require the weighing of the aggravating and mitigating circumstances by the preponderance of the evidence. Based on those factors, the court found that the constitutional challenges based on the Supreme Court rulings in *Apprendi* and *Ring* do not impugn Maryland's death penalty statute and affirmed the death sentence for Stephen Oken.

Miller v. State

John Miller was sentenced to death for the 1998 murder and attempted rape of a teenaged girl, Shen Poehlman, in Baltimore County. Miller appealed his death sentence to the Court of Appeals in early 2003. Miller appealed on several issues including the failure of the prosecution to disclose exculpatory evidence relating to the sexual offense charge and the standard of proof issues raised in *Ring*. The court has yet to issue a ruling on Miller's appeal, but it appears based on the recent *Oken* decision, that at least the *Ring*- based portion of the challenge is unlikely to succeed.

Wiggins v. Smith

In June 2003, the Supreme Court in *Wiggins v. Smith,* (No. 02-311, decided June 26, 2003) overturned the death sentence of Kevin Wiggins, who was sentenced to death for the 1988 murder of a 77-year-old woman in Baltimore County. His public defenders at the original sentencing moved to bifurcate the sentencing, representing that they planned to prove that Wiggins did not kill the victim by his own hand and then, if necessary, to present a mitigation case. The court denied the motion, and the defense never introduced evidence about the severe physical and sexual abuse Wiggins had reportedly suffered at the hands of his mother and while under the care of a series of foster parents. The court held that due to the fact that this potentially mitigating evidence was not introduced at the sentencing, Wiggins was denied his Sixth Amendment right to effective assistance of counsel. Although the first degree murder conviction stands, the holding overturns the sentencing in the case and requires a new sentencing hearing. The new hearing has not yet occurred.

2003 Legislation

Several bills were introduced in the 2003 session in response to the findings of the University of Maryland death penalty study, but none of the bills passed. Senate Bill 12/House Bill 16 would have enacted a moratorium on the death penalty until the General Assembly had a chance to study the report by the University of Maryland. Senate Bill 544 would have repealed the death penalty. Senate Bill 350 would have required the Court of Appeals, as part of its review of a death sentence, on the record to determine whether the imposition of the death sentence is excessive or disproportionate to the penalty imposed in similar cases, considering both the crime and the defendant. Additionally, Senate Bill 172 would have required the State to seek the death penalty in every first degree murder prosecution that meets the statutory requirements for death penalty eligibility, unless the victim's family does not want the State to pursue the death penalty.

In response to the *Apprendi* and *Ring* line of cases, Senate Bill 53 would have raised the standard of proof from a preponderance of the evidence to beyond a reasonable doubt for determining whether aggravating circumstances outweigh mitigating circumstances in the sentencing phase of a capital case.

Given the recent attention to the death penalty created by the findings of the University of Maryland study, the lifting of the 2002 moratorium and recent appellate court challenges to Maryland's death penalty statute, it appears likely that additional legislative proposals will be introduced in the 2004 session.

For further information contact: Kelly G. Dincau Phone: (410) 946/(301) 970-5350

Criminal Law

Prohibiting the Use of Cell Phones by Inexperienced Drivers

The issue of cell phone use while driving has been an area of national interest for several years now. As additional studies of cell phone use and other driver distractions have been undertaken, a number of states and the federal government have considered various restrictions on the use of cell phones while driving. One proposal that has gained recent attention is a recommendation by the National Transportation Safety Board to focus the restrictions on inexperienced drivers.

Background

The discussions surrounding the use of cell phones while driving focuses on the impact the phone has on the attention of the driver. Proponents of cell phone restrictions point to studies that indicate that drivers engaged in conversations on cell phones are less aware of the traffic movements around them and have slower reaction times in response to changing road conditions and are, therefore, more likely to be involved in a collision. According to media reports, a Harvard study from 2002 estimated that approximately one in 20 motor vehicle accidents in the United States involves a driver talking on a cell phone.

Opponents to such restrictions argue that prohibiting cell phone use unfairly targets one piece of equipment, while there are numerous other distractions for drivers, such as eating, drinking, playing the radio, and talking to other passengers. A joint study conducted by the University of North Carolina and the American Automobile Association in 2003 placed cameras in cars of volunteers to monitor the behind-the-wheel activities of the drivers. The study found that 91 percent of the drivers monitored were operating their car radio, 77 percent were talking to other passengers, 71 percent were eating or drinking, and 30 percent were talking on cell phones.

Legislation has been repeatedly proposed in many states, including Maryland, that would ban or otherwise restrict the use of cell phones while driving, and minor restrictions have been imposed in several states. In November 2001, New York became the first state to prohibit drivers from talking on handheld wireless telephones while operating a motor vehicle unless the driver is calling for assistance or to report a dangerous situation. The federal government currently has no regulations to address the use of cell phones in motor vehicles, but in 2001 lawmakers proposed legislation that would have required states to prohibit handheld wireless telephone devices in motor vehicles or risk losing federal highway funds.

New Driver Ban Recommended by the National Transportation Safety Board (NTSB)

A fatal accident that occurred on the Capital Beltway in February 2002 brought renewed interest to the subject of cell phone use in motor vehicles, particularly in relation to novice drivers. In the accident, a sport utility vehicle (SUV) crossed the median and landed on top of a minivan traveling in the opposite direction. All four occupants of the minivan and the driver of the SUV were killed. A NTSB Highway Accident Report determined the probable cause of the accident to be the failure of the SUV driver to maintain directional control of the vehicle in windy conditions due to a combination of inexperience, unfamiliarity with the vehicle, speed, and distraction caused by the use of a handheld wireless device. The driver of the SUV was a 20 year old woman who had just purchased the vehicle two hours before the accident and, despite having had her license for three years, had very little actual driving experience. Evidence showed that at the time of the accident the woman was talking on her cell phone to a friend who was in a car she was trying to follow.

As a result of this accident, NTSB, in its Highway Accident Report, issued a recommendation that states enact legislation to prohibit holders of learner's permits and intermediate licenses from using cell phones while driving.

2003 Legislation

During the past few years, several unsuccessful bills have been introduced in the General Assembly to restrict cell phone use while driving. Most recently, two proposals were introduced during the 2003 session dealing with this issue. House Bill 63 would have prohibited the driver of a motor vehicle from operating a hand-held phone while the vehicle is in motion except in an emergency. The penalty for a violation was one point assessed against the driving record and a fine of up to $500. Senate Bill 220/House Bill 554 would have prohibited a driver under the age of 18 from operating a cell phone, hand-held or wireless, while the motor vehicle is in motion except in an emergency. This bill carried a penalty of a fine not to exceed $500.

Possible Issues for the 2004 Session

As a result of NTSB's report following the accident on the Capital Beltway, the focus for the upcoming legislative session is likely to be on inexperienced drivers. New Jersey and Maine have already passed legislation that complies with the recommendations of the NTSB. New Jersey prohibits the holder of a provisional license from using any interactive wireless communication device while operating a motor vehicle except in an emergency. Maine prohibits a person who has been issued an instruction permit and a person under the age of 18 years who has been issued a restricted license from using a mobile telephone while operating a motor vehicle.

The legislation introduced in 2003 restricting drivers under the age of 18 from operating a motor vehicle while using a cell phone would have only partially addressed the issues raised by NTSB. The driver of the vehicle that crossed the median in the beltway accident was an inexperienced driver, but was not a minor. Legislation in the 2004 session may address cell phone use by any novice driver as opposed to focusing solely on minor drivers.

For further information contact: Kelly G. Dincau Phone: (410) 946/(301) 970-5350

Criminal Law

Jury Trial Prayers

Criminal cases transferred from the District Court pursuant to requests for jury trials have contributed to increasing criminal caseloads in the circuit courts. Despite past efforts to resolve the problems created by high numbers of jury trial requests, no solution has been successful in addressing the caseload burdens created by the requests. The Horne Committee has been meeting during the 2003 interim to study the issue of jury trial prayers on behalf of the Judiciary and to examine possible solutions.

Background

The right to a trial by jury is guaranteed in Articles 5, 21, and 23 of the Maryland Declaration of Rights. In the State's two-tiered trial court system, less serious cases (typically misdemeanors) generally originate in the District Court while felonies and other more serious cases originate in the circuit courts. However, jury trials are only available in circuit court. Therefore, if a criminal case originates in the District Court, and the defendant is entitled to a jury trial, the defendant may file a "jury trial prayer," which transfers the case to circuit court.

Beginning in the 1970s, the numbers of jury trial prayers increased significantly, causing a workload problem in the circuit courts. The problem has persisted since that time to varying degrees. It is known that jury trials are often requested for reasons other than to actually obtain a jury trial, including delay, avoidance of a particular judge or prosecutor, and convenience of defense counsel. Because most of these cases are resolved at the circuit court level prior to the trial phase, only a small fraction of jury demands ultimately result in jury trials. Nevertheless, a large number of jury demands does burden the system.

Gerstung Rule and Related Case Law

Judicial committees were formed in the late 1970s and mid-1980s to study this issue and recommend solutions, spawning a number of corrective efforts. In 1981, the so-called "Gerstung Rule" (§4-302(e) of the Courts and Judicial Proceedings Article) was enacted, which eliminates a defendant's right to a jury trial at the initial trial level if the judge agrees not to impose a sentence of imprisonment of more than 90 days. The extent to which the Gerstung Rule prompted a decrease in the number of jury demands in the years after its implementation is unclear. In any event, the Court of Appeals held the rule to be unconstitutional as applied to the specific offenses charged in three cases in the mid-1980s. See *Kawamura v. State*, 299 Md. 276 (1984); *Fisher v. State*, 305 Md. 357 (1986); and *State v. Huebner*, 305 Md. 601 (1986).

The codified Gerstung Rule was an attempt by the General Assembly to provide clear guidelines with respect to a defendant's right to a jury trial in the first instance (election of a jury trial in the circuit court in lieu of being tried without a jury in the District Court) versus obtaining a jury trial through a defendant's right to a *de novo* appeal to the circuit court following a conviction without a jury in the District Court. By establishing a 90-day penalty threshold, the General Assembly attempted to distinguish petty offenses that under common law historically did not trigger the right to be tried by a jury from other offenses to which the constitutional right applied. The General Assembly was trying to define the circumstances under which a defendant did not have a right to a jury trial in the first instance in order to reduce the number of jury trial prayers.

The *Kawamura*, *Fisher*, and *Huebner* holdings made clear that it is not merely the length of sentence that determines a petty offense or the right to deny a defendant the right to a jury trial at the initial trial level. In those cases, the Court of Appeals outlined the factors that must be considered in determining whether the State constitutional right attaches to an offense at the initial trial level. The court analysis involves whether the offense (1) had historically been considered a petty offense subject to the jurisdiction of justices of the peace or historically had been tried before juries; (2) is an infamous crime or is subject to infamous punishment; (3) is considered to be a "serious crime;" (4) has a significant maximum statutory penalty; and (5) is subject under statute to incarceration in the penitentiary. The relative lack of clarity in these cases as to which offenses are entitled to a jury trial in the first instance may be a contributing factor in the continued high numbers of jury trial prayers.

Same Day Jury Trial

Another remedial measure that has been tried by Baltimore City, Baltimore County, and Montgomery County is a program in which a defendant who requests a jury trial in the District Court is scheduled for a jury trial in circuit court either on the same day on which the request is made or soon thereafter. These programs have met with differing degrees of success. It is believed that the viability of such a program is dependent on such factors as the personalities of those administering the program and the size of the jurisdiction.

The Horne Committee

Jury demands have again increased significantly. Statewide, the number of jury trial prayers increased by over 24 percent between fiscal 1998 and 2002, and cases transferred to circuit court pursuant to jury trial prayers composed approximately 44 percent of the total number of criminal filings in circuit court in fiscal 2002. Consequently, at the request of the Conference of Circuit Judges, Chief Judge Bell of the Court of Appeals established an ad hoc committee, chaired by Judge William S. Horne, to study the issue and recommend possible solutions. Unlike the previous committees that studied this issue, which were composed almost exclusively of judges, this committee included representatives of all sectors of the criminal justice system. The committee convened on August 13, 2003, and held five meetings including an organizational meeting, two public hearings, and two work sessions.

Recommendations

The Horne Committee's recommendations to the Conference of Circuit Judges include:

- creating subcategories of certain misdemeanors for which the maximum imprisonment penalty would be limited to 90 days or less (which would be another attempt to delineate those crimes for which the right to a jury trial does not attach at the initial trial level and provide prosecutors with more charging discretion);

- encouraging District Court judges to become more active in binding plea agreements;

- requiring appeal bonds to remain the same on appeal from District Court unless the court finds that the defendant is dangerous;

- adding an initial appearance process for all jailable offenses in District Court (at which point defendants would be advised of their rights and encouraged to obtain counsel); and

- eliminating *de novo* trials in appeals of cases in which there is no right to a jury trial in the first instance.

The committee also recommended that the possibility of making six-person juries available in District Court be studied in the future.

Civil Proceedings

Tort Issues

Rising liability costs, particularly in the area of medical malpractice insurance, have engendered calls for legislative "tort reform" across the country. Efforts in Maryland may focus on reducing the limitation on noneconomic damage awards and limiting attorneys' contingency fees.

Debate Over Causes of Rise in Medical Malpractice Insurance Costs

Across the country, health care providers have recently faced substantial increases in medical malpractice insurance costs after a period of relative cost stability in the 1990s. In 2002, the increases reached 15 percent nationally, between 40 and 80 percent in a few states, and upwards of 200 percent in some areas for health care providers who practice in high-risk specialties (*e.g.*, obstetrics, neurosurgery, cardiovascular surgery, and emergency medicine).

Rates for medical malpractice insurance in Maryland had been relatively steady in recent years, increasing an average of only 7 percent from 2000 to 2002. This changed dramatically in 2003. In August, the Medical Mutual Liability Insurance Company (Med Mutual), which insures approximately 80 percent of the physicians in private practice in the State, obtained authorization from the Maryland Insurance Administration to raise its rates by 28 percent – the largest increase in 15 years. The Maryland State Medical Society (MedChi) blames the rate increase on the increasing severity of claims against physicians. The size of the average payment on a medical malpractice claim rose by more than 50 percent in the last four years, and the number of large payouts – defined as $400,000 or more – increased by more than 70 percent. MedChi maintains that Maryland will soon join the national medical insurance "crisis" unless the State's medical liability system can be brought "under control."

Other organizations, however, have disputed that the medical malpractice insurance industry's financial problems are the result of a rise in the severity of lawsuits. In September, Public Citizen's Congress Watch (Public Watch), a Washington-based nonprofit watchdog group, issued a report claiming that Med Mutual, like other insurers across the country, is merely a "victim of the economy." Investments made by these companies during the bull market of the 1990s have suffered heavily since the downward turn of the stock market. The root cause of the rise in rates, according to Public Watch, is the marketplace – not litigation.

Legislative Proposals

Those who blame the tort system for the rising costs have advanced several legislative proposals at both the federal and state levels. In Maryland, tort liability protections, including a reduction of the limitation on noneconomic damages and an attempt to curb attorneys' contingency fees in medical malpractice cases, are being considered.

Reduction of Noneconomic Damages Cap

Noneconomic damages in medical malpractice actions or other torts for personal injury or wrongful death include pain, suffering, physical impairment, and disfigurement. Seventeen states, including Maryland, have a cap on noneconomic damages. Five states have a cap on all damages, both noneconomic and economic. Maryland's limitation on noneconomic damages in any personal injury or wrongful death case, including medical malpractice cases, is currently $635,000 and increases by $15,000 annually. In a wrongful death case in which there are two or more beneficiaries, an award for noneconomic damages may be up to 150 percent of the cap.

Legislation may be proposed to reduce the current cap to more closely resemble the limits of other states' caps, which generally range from $250,000 to $350,000. In fact, of the 16 other states that have a cap on noneconomic damages, none is higher than Maryland's. MedChi has launched what it calls the "Malpractice Insurance Crisis Readiness & Action (MICRA) Campaign" to lobby for changes in Maryland tort law, of which a key element is reducing Maryland's cap on noneconomic damages.

Limits on Attorneys' Contingency Fees

Contingency fees are paid to attorneys only if a client wins or settles a lawsuit, enabling those who cannot afford up-front legal fees to secure legal representation. The size of the fee is negotiable, in theory, and is subject to the prohibition on excessive fees contained in the Maryland Rules of Professional Conduct, but in practice a contingency fee in a personal injury or wrongful death case tends to be at least one-third of the amount recovered. Maryland generally has no statutory restrictions on contingency fees, with the exception of claims under the Maryland Tort Claims Act.

Common Good, a legal reform group, argues that it is unethical for an attorney to charge the same percentage when a defendant is willing to settle early on terms favorable to the injured party. Common Good has filed a petition in the Maryland Court of Appeals asking the court to establish a rule in which plaintiffs' attorneys would be required to submit notices of claims to defendants in each case where a contingency fee is proposed and give the defendant an opportunity to make an early settlement offer. If a claimant accepts an early offer, the attorney's fee cannot exceed 10 percent of the settlement amount. It is argued that mandating lower contingency fees in these situations may also provide an additional incentive to settle litigation and reduce litigation costs and caseloads.

Proponents of the proposed rule may seek to put a similar proposal into effect for medical malpractice cases through legislation rather than wait in hope of seeing it judicially imposed.

For further information contact: John J. Joyce Phone: (410) 946/(301) 970-5350

Civil Proceedings

Child Abuse and Neglect – Termination of Parental Rights

Legislation in the area of child abuse and neglect may be generated in light of recent high profile cases involving the deaths of two young children as a result of child abuse. In addition, the Maryland Judicial Conference may resubmit a major bill rewriting the law governing termination of parental rights.

Child Abuse

In December 2002, 15-year old Ciara Jobes was fatally beaten by her mentally ill court-appointed guardian, Satrina Roberts, in Baltimore City. Roberts reportedly starved Ciara and locked her in a room for months before killing her. *The Sun* described the Jobes case as "one of the city's worst cases of child abuse."

In January 2003, police investigators found five-year-old Travon Morris submerged in a bathtub of scalding water. The child suffered first and second degree burns over 50 percent of his body and died from his injuries in February. His mother pleaded guilty to the charge of child abuse resulting in death and was sentenced to 30 years in prison, with 10 years suspended.

As a result of these tragedies, questions are being raised about the State's child protection laws and polices. Consequently, legislation may be introduced in the upcoming session to add additional procedural safeguards to the laws governing child abuse and neglect. Additional protections may also be added to the guardianship process, including requiring the disclosure to the court of mental health information that might affect a prospective guardian's ability to care for a minor.

Permanency for Families and Children

For the last three years, the Maryland Foster Care Court Improvement Project (FCCIP) of the Maryland Judicial Conference has undertaken a detailed review of the laws governing termination of parental rights (TPR) and adoption. FCCIP is a federal grant-based project created to improve the processing of Child in Need of Assistance (CINA) and related cases. (FCCIP undertook revision of the CINA statute, which was enacted in 2001.)

A CINA subcommittee (consisting of judges, masters, attorneys, Department of Human Resources' personnel, and others who serve as members or consultants) is responsible for the review and revision of the TPR and adoption statutes. The CINA subcommittee found that the existing TPR and adoption statutes combine different substantive areas that require different procedures, resulting in unnecessary complexity. The current statutes are not written in chronological procedural order and include archaic language. Also, the laws contain ambiguous provisions.

As a result of the findings of the CINA subcommittee, during the 2003 session a proposed revision of TPR and adoption statutes was introduced as Senate Bill 266/House Bill 183. The bills, however, were withdrawn at the request of the Judiciary before legislative hearings took place, because the bills needed substantial organizational and language revisions. The proposed revision was intended to separate Department of Human Resources-related TPR and adoption proceedings, private agency adoption and guardianship proceedings, and independent adoption proceedings into discrete sections. In addition to addressing procedural and organizational issues, the legislation attempted to ensure that certain case law would be codified and relevant federal provisions that could impact program costs would be included. The legislation also incorporated certain “best practices,” such as facilitation of open adoptions and conditional consents to TPR and adoption.

During the interim, the CINA subcommittee completed an updated revision of the TPR and adoption statutes entitled the “Permanency for Families and Children Act of 2004,” which is likely to be introduced in the 2004 session.

For further information contact: Karen D. Morgan Phone: (410) 946/(301) 970-5510

Civil Proceedings

Same-sex Civil Unions and Marriages

In the wake of the recent U.S. Supreme Court decision invalidating the sodomy law in Texas and the recent ruling by the Supreme Judicial Court of Massachusetts that the prohibition against marriage for same-sex couples violates the Massachusetts Constitution, there has been much discussion concerning the legal status of individuals of the same sex who enter into a familial relationship. Legislation may be introduced to (1) legalize same-sex marriage; (2) recognize "civil unions" akin to marriage for homosexual couples; or (3) extend to same-sex partners the rights and benefits that married couples enjoy. On the other hand, opponents may introduce legislation to specifically provide that Maryland does not recognize same-sex marriages performed in another jurisdiction.

Background

In June 2003, the U.S. Supreme Court held that a Texas statute, which criminalizes certain intimate sexual conduct by two persons of the same sex, is an unconstitutional violation of the right to privacy. *Lawrence et al. v. Texas*, ____ U.S. ___, 123 S.Ct. 2472 (2003). In its decision, the court stated that the petitioners, a homosexual couple, "are entitled to respect for their private lives" and that "[t]he State cannot demean their existence or control their destiny by making their private sexual conduct a crime." *Id.*

In November 2003, the Supreme Judicial Court of Massachusetts held that barring an individual from the protections, benefits, and obligations of civil marriage solely because that person would marry a person of the same sex violates the Massachusetts Constitution. The court stayed the entry of the judgment for 180 days to permit the Massachusetts Legislature to take appropriate action in light of the opinion. These recent decisions have given gay rights advocates hopes of expanding gay rights in Maryland. Most notably, legislative proposals during the 2004 session may include a controversial measure to legalize same-sex marriage or to recognize "civil unions" akin to marriage for homosexual couples. In the alternative, measures may be introduced to extend to same-sex partners the same benefits and rights, such as health and retirement benefits and the right to make health care decisions, that married couples enjoy.

Opponents argue that such legislation would undermine traditional marriage between heterosexual couples and are likely to propose legislation to specifically provide that Maryland does not recognize same-sex marriages performed in another jurisdiction.

Current Law

Under current law, only a marriage between a man and a woman is valid in Maryland. Under the Full Faith and Credit Clause of the U.S. Constitution, states are required to give full faith and credit to the public acts, records, and judicial proceedings of every other state. Therefore, Maryland will recognize foreign marriages that are validly entered into in another state. For example, Maryland will recognize a common law marriage from a foreign jurisdiction, although common law marriages are not valid in Maryland. *Henderson v. Henderson*, 199 Md. 449 (1952). However, the Full Faith and Credit Clause does not require a state to apply another state's law in violation of its own legitimate public policy. See *Nevada v. Hall*, 440 U.S. 410 (1979). Similarly, the *Henderson* court stated that Maryland is not bound to give effect to marriage laws that are "repugnant to its own laws and policy." 199 Md. at 459.

In 1996, Congress passed the "Defense of Marriage Act," which allows a state to deny recognition of a public act, record, or judicial proceeding of any other state respecting a relationship between persons of the same sex that is treated as a marriage under the laws of the other state.

Prior Legislative Initiatives

Legislation relating to the legal status of individuals of the same sex who enter into familial relationships is not new in Maryland. Measures to legalize homosexual marriage were proposed in the 1998 session (House Bill 1259) and in the 2000 session (House Bill 919) but were unsuccessful. Also unsuccessful were opposing proposals to ban recognition of lawful out-of-state marriages by same-sex couples (House Bill 1268 of 1996, House Bill 398 of 1997, Senate Bill 565 of 1998, House Bill 1128 of 1999, and House Bill 531 of 2001).

Other Jurisdictions

Same-sex marriage is legal in the Canadian provinces of Ontario and British Columbia as well as in the Netherlands and Belgium. Several countries, including Denmark, France, and Germany, and the state of Vermont allow same-sex couples to join in "civil unions" that provide many of the same rights and benefits as marriage.

According to the National Conference of State Legislatures, five states – California, Connecticut, New York, Vermont, and Washington – provide insurance benefits to domestic partners of state government employees. In addition, Delaware, Massachusetts, and Oregon provide limited benefits, such as bereavement leave, for domestic partners of state employees. In Maryland, Montgomery County, Baltimore City, Greenbelt, and Takoma Park offer employees domestic partner benefits.

By contrast, approximately 37 states (excluding Maryland) have passed defense of marriage acts, modeled on the federal Defense of Marriage Act, which deny recognition of same-sex marriages solemnized in another jurisdiction.

For further information contact: Lauren C. Nestor Phone: (410) 946/(310) 970-5350

Civil Proceedings

Juvenile Facilities

Legislation addressing the problems reported by the press may deal with supervision of juveniles and overcrowding in the Charles H. Hickey, Jr. School and the Cheltenham Youth Facility. Additional legislative proposals may address issues regarding group homes for children.

Background

News reports this interim highlighted serious and chronic shortcomings within the juvenile justice system. The reports depicted incidences of child abuse, riots among youth, violence of staff toward youth, and escapes at two Department of Juvenile Services facilities, both of which present a troubled history. Investigations of the Charles H. Hickey, Jr. School and the Cheltenham Youth Facility revealed serious overcrowding and staff inadequacies at both facilities.

Charles H. Hickey, Jr. School

The Charles H. Hickey, Jr. School in Baltimore County is a major component of the department's residential program. The facility, which is operated by a vendor in the final months of a multiyear contract, houses the most serious male offenders under the department's jurisdiction. Of the over 260 boys at the facility, some are detained there awaiting a hearing while others are placed there by the court at disposition. Recent audits and inspections by the Office of the Independent Juvenile Justice Monitor within the Office for Children, Youth, and Families found serious problems with the current vendor's management of the facility. In addition, the U.S. Department of Justice has begun a civil rights investigation.

The Office of the Independent Juvenile Justice Monitor reported numerous incidences of child abuse, violence of staff on youth and youth on youth, and attempted and completed escapes. The monitor cited Hickey as an unsafe and even hostile environment. The monitor also criticized the vendor for failing to provide the juveniles with adequate mental health and educational services. In fact, this summer the vendor reimbursed the State nearly $800,000 on its contract, including almost $500,000 for failure to deliver educational services.

The fiscal 2004 budget allowance included funding to turn the Hickey educational program over to the State Department of Education. Because of budgetary considerations, however, the General Assembly delayed implementation until July 2004, contingent on funds being included in the fiscal 2005 budget, through enactment of HB 860 (Chapter 53 of 2003). With the contract to operate Hickey ending in March 2004, legislation ensuring that proper supervision and appropriate treatment programs are part of the new contract at Hickey may be introduced in the upcoming session.

Cheltenham Youth Facility

Cheltenham Youth Facility in Prince George's County is designed to be a short-term detention facility with minimal rehabilitative services for male offenders from southern Maryland; however, use of the facility has expanded beyond those parameters. In practice, Cheltenham houses youth from other parts of the State, particularly Baltimore City, from which one-third of its population originates, and has become not only a secure detention facility but also a facility to house youth pending a court-ordered placement in another facility.

While Cheltenham is not designed to hold juveniles longer than 60 days, over 20 percent of its population is detained for longer periods. Cheltenham is overcrowded, usually housing over 200 youth on a daily basis in a facility built for no more than 180. Last spring, overcrowding led to a riot among youth from different cottages, and county and State law enforcement were called in to regain control of the facility. The Independent Juvenile Justice Monitor's report on the crisis attributed the loss of control to overpopulation and inadequate staff and supervision.

The Department of Juvenile Justice has responded by closing three of eight cottages and moving the youngest detainees, who are under 14 years old, to another facility. The department plans to downsize Cheltenham and redevelop it as a regional facility with adequate mental health and addiction services. Part of this reform depends on the transfer of Baltimore City youth out of Cheltenham and into the newly completed Baltimore City Juvenile Justice Center.

Legislation may address issues of overcrowding and staff inadequacies at detention facilities such as Cheltenham.

Other Legislative Initiatives

Other legislation may be introduced relating to issues regarding group homes for children, particularly those children under the care of the department. Specifically, legislation may attempt to address the problems of licensing the homes, certifying group home administrators, the saturation of group homes in certain communities, the supervision and monitoring of children in the homes, and the maintenance and management of properties used for the homes.

For further information contact: Susan O. McNamee Phone: (410) 946/(301) 970-5350

Environment and Natural Resources

Fisheries Management

In tandem with the decline of the water quality in the Chesapeake Bay has been the depletion of its native fishery resources. What are the most effective ways to restore, and perhaps even enhance, these native stocks? Responses may include further development of the aquaculture industry and the introduction of nonnative species. Pending fishery restoration, how does the State determine access to these limited resources? Possibilities include consideration of "right to fish" legislation and restructuring of commercial licenses.

Background

The steady deterioration of water quality in the Chesapeake Bay watershed and the diminishing productivity of related fisheries have been well documented over the past two decades. Experts, however, warn that these declines are now at an all time crisis.

Particularly toxic to the bay and its tributaries is the huge influx of nitrogen. In excess, this nutrient ultimately deprives fish and shellfish of oxygen and blocks sunlight from reaching underwater grasses, which naturally clean the water and serve as vital habitat for fish and crabs. The magnitude of these "dead zones," areas that lack oxygen and aquatic life, is far greater this year than ever before recorded. Data from the United States Environmental Protection Agency and the Virginia Institute of Marine Sciences report a dead zone of 250 square miles. Totaling about 40 percent of the entire bay, this zone stretches about 15 miles further north and 50 miles further south than last year's boundary. Looking ahead, experts predict that the bay's rising water temperatures can only further deplete this scarce oxygen supply.

The degradation of bay fisheries mirrors these water quality developments. At one time, Maryland produced between 1 and 2 million bushels of oysters each year, roughly half the total national production. In 2001 through 2002, the commercial harvest was 148,000 bushels; last season the take totaled 53,000 bushels, the smallest since recordkeeping began in 1870. For a variety of reasons, early indications are that this year's commercial blue crab harvest will come in significantly below the 10.7 million pound average of the past eight years. Perhaps the most telling indication of the extreme stress under which the bay now labors is the increased number of crab "jubilees" in which crabs crawl out of the water in order, literally, to catch their breath. Also increasing in frequency is the harvest of dead crabs and finfish.

Restoration and Enhancement of Native Fishery Stocks

Is it all bad news for native fishery stocks? Not necessarily. Hopeful indications include the rebounding of underwater grasses, this year measured at their highest level in nearly 30 years. In addition, the 2003 population of juvenile rockfish, not long ago a species in crisis, more than doubled the long-term average.

Also on the horizon for restoration of native stock is the developing science of aquaculture, which is the commercial rearing of finfish and shellfish. The Task Force to Study the Economic Development of the Maryland Seafood and Aquaculture Industries was established, in part, to “jump start” the aquaculture industry. The final report and recommendations of the task force will be complete in the fall of 2004; the introduction of related legislation is anticipated for the 2005 session.

For those whose livelihoods depend on the commercial fishing and processing industries, restoration of native stock is viewed as too speculative, let alone lengthy, a process. They therefore advocate enhancement of Maryland’s native stock by rearing nonnative species such as the Asian oyster, which has already been advanced in Virginia studies. This species exhibits great resistance to the two parasitic diseases, MSX and Dermo, which have destroyed the native oyster population in recent years. Legislation enacted in 2002 requires the Department of Natural Resources (DNR) to pursue the study of this species’ viability and its likely environmental impact; a final report is due in December 2004. While conceding the many apparent benefits of the Asian oyster, environmentalists fear the unknown impact of introducing another nonnative species to the bay ecosystem. In support for this caution, they cite an August 2003 report by the National Research Council that urges as much as five years of additional research before the Asian oyster is actually introduced into State waters.

The Ehrlich Administration, however, has vigorously promoted this nonnative alternative. In October 2003, the Board of Public Works approved a request by the University of Maryland Center for Environmental Science to experiment with Asian oysters in three bay tributaries; approval of this plan will also be required by the Army Corps of Engineers. The introduction of State legislation is anticipated from both sides of this issue – those who want to accelerate the pace of these experiments and those who want to slow them down. Meanwhile, federal oversight of these matters is also being discussed.

Access to Limited Resources

Presuming the eventual achievement of fishery restoration or enhancement, the interim question remains: how to balance these limited resources? Debate abounds in nearly every facet of fishery management. To name just a few current issues, the commercial fishery, the sports fishery, and the environmental community each has its own perspective on minimum crab size for harvest, the creation of oyster nurseries by dredging for recovered shells, and proposed restrictions on the harvest of horseshoe crabs. Given how pressed the fisheries are, it is expected that several resource allocation questions will be presented in the upcoming session.

In keeping with a national trend, controversial “right to fish” legislation was introduced during the 2003 session that would have established rather stringent conditions for the closure of a fishery to the sports fishery. Unable to accommodate the interests of all user groups involved, the bill failed. Following further interim efforts, however, the parties report that a consensus has been reached, and legislation will be introduced during the 2004 session to reflect this resolution.

Finally, because of resource scarcity and other economic pressures, many watermen do not fully utilize the entitlements of their licenses. Since the extent of the impact of this “latent” fishery on the commercial fishery at large is unknown, DNR is in the process of ascertaining that information. Depending on a number of variables, legislative or regulatory changes may be introduced to restructure the commercial fishery.

Environment and Natural Resources

Critical Area Law

Nearly 20 years after enactment, the State's critical area program, particularly its enforcement component, continues to be refined. Following a recent Court of Appeals decision, key aspects of the variance process may require statutory clarification. Other priorities relate to enforcement mechanisms available to local programs.

Background

The Maryland General Assembly established the Chesapeake Bay Critical Area Protection Program in 1984 in order to minimize damage to water quality and wildlife habitat by fostering more sensitive development activity along the shoreline areas of the Chesapeake Bay and its tributaries. The law identified the "critical area" as all land within 1,000 feet of the mean high water line of tidal waters or the landward edge of tidal wetlands and all waters of and lands under the Chesapeake Bay and its tributaries. Viewed as particularly sensitive were the "buffer areas" falling within 100 feet of the shoreline. Because the unique and critical environmental functions of these buffers were regarded as compromised by clearing and construction, their protection was considered a cornerstone of the program.

The 1984 legislation also created a statewide Chesapeake Bay Critical Area Commission that oversees the development and implementation of local land use programs dealing with the critical area. As required, the commission adopted regulations to implement overall program criteria, and these criteria were approved by the General Assembly in 1986. Each local jurisdiction is charged with the primary responsibility for development and implementation of its own local program; that local authority, however, is subject to commission review and approval. The number of local programs now totals 63, including Baltimore City, 17 counties, and 45 municipalities.

In three cases decided in 1999 and 2000, the Maryland Court of Appeals reinterpreted long held understandings of "unwarranted hardship" in the context of local zoning variances in the buffer area. At issue were: what extent of reasonable and significant use of a property must be denied before the owner would be eligible for a variance; whether satisfaction of all variance standards would be required or merely general satisfaction; and the fairness of comparing a new request to nonconforming uses developed before 1984 or to variances granted after the institution of the critical areas program. Legislation enacted in 2002, which in effect overruled the Court of Appeals in these three cases, clarified the underlying intent to protect the viability of the buffer area. Also in 2002, critical area program protections were expanded to include the Atlantic Coastal Bays.

Most Recent Court of Appeals Decision

In July of 2003, the Court of Appeals again departed from widely understood principles of critical area zoning law in the case of *Lewis v. Department of Natural Resources*. This ruling allowed for the construction of a hunting camp in the environmentally sensitive buffer. Several facts seemed of slight or no bearing to the court: the landowner commenced building before applying for a variance or other local permits; the property could have accommodated an alternative lay-out of the camp buildings; and serious environmental degradation had occurred. Likewise appearing to carry little, if any, weight was the consideration of the cumulative environmental impact of development on an ongoing basis.

In addition to these direct implications for the State's water quality, this ruling is likewise seen to have grave ripple effects. Legal scholars regard *Lewis* as shifting the burdens of proof and persuasion from an applicant seeking a variance to the local program if it denies the variance request. The impact of this shift, in effect requiring a local program to disprove the need for the variance, is predicted to cause significant escalation of administrative costs associated with each local program, thus crippling enforcement of the entire critical area program. Moreover, this decision is expected to impact a variety of other legal issues related to land use and zoning.

In October, the court denied the commission's request for reconsideration or clarification, thus affirming its original ruling. It is expected that legislation will be introduced during the 2004 session to override the court and retool several aspects of the critical area program.

Other Enforcement Issues

The commission also views enhanced enforcement of critical area requirements as a program priority. Legislative options may include: increased penalties for program violations; authorization of mitigation performance by a local program when a property owner refuses to comply, with costs to be borne by the property owner; streamlining of the referral process so that violations may be more vigorously pursued by the Office of the Attorney General; clarification of varying local interpretations of key program definitions; and more specific disclosure to purchasers of affected properties regarding program components.

For further information contact: Margaret G. McHale/T. Patrick Tracy Phone: (410) 946/(301) 970-5350

Environment and Natural Resources

Brownfields

The federal brownfields law was amended in 2002 to, among other things, provide new liability defenses for contiguous property owners, prospective purchasers, and innocent landowners. These changes, and other related topics, have been the focus of a State task force established during the 2003 session. The task force's recommendations may lead to legislative activity during the 2004 session.

Background

Brownfields are industrial or commercial properties that are undeveloped or underdeveloped because of actual or suspected hazardous contamination. A majority of brownfield sites are located in urban areas; encouraging the cleanup and redevelopment of these sites has been an important component of urban redevelopment programs throughout the country. Generally, developers are reluctant to purchase and develop such sites for fear of being responsible for cleanup costs that can run into the millions. In addition, responsible parties are often either difficult to find or judgment proof.

In 1997, the Voluntary Cleanup Program (VCP) and the Brownfields Revitalization Incentive Program (BRIP) were created within the Maryland Department of the Environment (MDE) and the Department of Business and Economic Development, respectively, to encourage the cleanup and redevelopment of brownfields in the State. VCP provides liability relief to owners or purchasers of a contaminated site who did not contribute to the contamination if cleanup goals are met. As of September 10, 2003, 160 properties had applied to enter VCP; 82 have completed the program. BRIP provides grants, low-interest loans, and tax credits to clean up and redevelop qualified brownfield sites. To date, the program has approved 24 projects to receive State funds, totaling $4.7 million.

2002 Federal Brownfields Legislation

In early 2002, President George Bush signed the Small Business Liability Relief and Brownfields Revitalization Act. Title II provided three new liability defenses to brownfields liability under federal law; specifically, the Act defines and affords defenses to contiguous property owners, bona fide prospective purchasers, and innocent landowners. The Act imposes a number of inquiry, notice, and care requirements on owners seeking to qualify for these defenses. Of particular importance, an owner seeking to use one of these defenses must have conducted "all appropriate inquiry" into the contamination at the property prior to purchase.

The Act defines contiguous property owners as owners of property that is contaminated solely from a contiguous property. In order to receive liability protection, the property owner, in addition to meeting the common requirements discussed above, must not have caused or contributed to the release, must not own the contiguous property, and must not be affiliated with the owner of the contiguous property. Bona fide prospective purchasers are persons who, in addition to meeting the common requirements discussed above, acquired a site after January 11, 2002, did not cause or contribute to the contamination, and are not affiliated with any other potentially liable person. Once a person has established a defense as a bona fide prospective purchaser, the U.S. Environmental Protection Agency (EPA) may place a "windfall lien" on a property for the increase in the fair market value of that property attributed to EPA's cleanup efforts. Finally, innocent landowners are persons who conducted "all appropriate inquiry" prior to purchasing the site and either determined that the site was not contaminated or had no reason to know that it was contaminated.

2003 State Legislation and Implications for the 2004 Session

Chapter 466, Acts of 2003, among other things, adopted the contiguous property liability exemption of the federal act. By doing so, Chapter 466 actually changed the defense to an exemption from consideration as a "responsible person" under State law. As part of adopting the exemption, the statute references the requirements of the federal act as well as any regulations adopted by MDE interpreting those requirements. Of particular importance is the federal requirement that the contiguous property owner conduct "all appropriate inquiry" into the environmental condition of the site. This phrase is currently the subject of federal rulemaking, and the exact parameters of the required inquiry are obviously of great importance to developers and environmental interests alike.

Chapter 466 also established a task force to review the other liability protections provided by the federal act, examine the consequences of enacting similar changes at the State level, examine other changes to the VCP, and generally review the State's brownfields programs. The task force is required to report its findings and recommendations to the Governor and the General Assembly by December 31, 2003. In the course of the task force meetings, the Administration has expressed its intent to introduce legislation to amend VCP. While specific proposals are unknown at this time, the task force is considering the following issues: (1) adopting the other liability exemptions and the windfall lien provision adopted under the federal act; (2) altering the investigation required to enter VCP; (3) allowing properties under active enforcement to be eligible for VCP; (4) expanding liability protections to local governments who take ownership of contaminated property; (5) allowing persons entering the VCP to conduct cleanups for only one contaminant or for limited areas of the property; and (6) expanding funding for State brownfields programs and generally streamlining the cleanup process. These issues will likely constitute key portions of any legislation introduced during the 2004 session.

For further information contact: Joshua W. Ferguson Phone: (410) 946/(301) 970-5350

Environment and Natural Resources

Nutrient Management

Implementation problems with the Water Quality Improvement Act of 1998 have caused great concern in the agricultural community. Legislation attempting to address those problems was introduced during the 2002 and 2003 sessions but was unsuccessful.

Background

The Water Quality Improvement Act (WQIA) of 1998, as amended by Chapter 485, Acts of 2000, provides for a variety of measures aimed at improving water quality throughout the State, including mandatory development and implementation of nutrient management plans by farmers. Agricultural operations using chemical fertilizer were required to implement nitrogen- and phosphorous-based plans by December 31, 2002. Farmers using sludge or animal manure were required to implement nitrogen-based plans by December 31, 2002, and must implement nitrogen- and phosphorous-based plans by July 1, 2005. Farmers were able to have plans developed for free by a University of Maryland Cooperative Extension Service consultant, or they could share costs with the State to have a private consultant develop a plan. Farmers who were unable to obtain the services of a consultant were able to submit a Justification for Delay form signed by a consultant indicating an approximate plan completion date.

For a variety of reasons, including a dearth of certified consultants and problems with public awareness, many operations did not meet the 2002 deadline for plan implementation. A number of bills were introduced during the 2002 and 2003 sessions to address WQIA implementation problems; all of which failed. The bills contained provisions that would have, among other things, exempted certain farmers from the plan requirements, extended the deadlines for farmers to develop plans, and temporarily suspended enforcement of the penalty provisions applicable to the nutrient management plan provisions of WQIA.

Current Status of Compliance

Exhibit 1 shows nutrient management plan compliance levels as of September 30, 2003. The Maryland Department of Agriculture (MDA) estimates that plans are required for 9,035 farms covering approximately 1,600,000 acres. As of September 30, 2003, MDA had received 5,104 plans for the management of 1,046,053 acres, and 1,649 Justification for Delay forms covering 311,490 acres. While progress has been made, overall, 43 percent of the farms and 34 percent of the regulated acreage still lack plans approximately one year after the deadline. Recently, compliance activity has leveled off. MDA suspects this is the result of broad belief that legislative changes to WQIA are forthcoming.

Exhibit 1
Nutrient Management Program Compliance
(As of September 30, 2003)

	Final Plans	Delay Forms	Compliant/ In Progress	Non-Compliant	Total
Farms	5,104 (57%)	1,649 (18%)	6,753 (75%)	2,282 (25%)	9,035
Acres	1,046,053 (66%)	311,490 (19%)	1,357,543 (85%)	242,457 (15%)	1,600,000

Source: Maryland Department of Agriculture

In an effort to encourage plan development and implementation, MDA has sent a series of five statewide mailings to farming operations since WQIA was enacted. Through these mailings, MDA has attempted to provide information about the law's requirements, encourage the development of plans, and educate the regulated community. The most recent notices were focused on non-compliant farming operations. To date, MDA has not assessed any penalties for non-compliance; it is unclear at this time whether MDA will do so.

Implications for the 2004 Session

In July and August 2003, MDA hosted two broad efforts to garner information for improving the State's implementation of WQIA. In July, MDA hosted a one-day briefing on recent nutrient management research findings. At the briefing, information was presented on the most recent advances in the field of nutrient dynamics and on management strategies that may help farmers implement nitrogen- and phosphorus-based plans. MDA's one-day nutrient summit in August involved more than 300 stakeholders brainstorming ways to make WQIA easier to implement and more effective at protecting the environment. Common themes that emerged from the summit included recommendations to:

- address the current statutory language regarding right-of-entry to farms;
- simplify the program's paperwork and reporting requirements;
- use more incentives – financial and recognition – for plan implementation; and
- streamline MDA's efforts to ensure the quality of nutrient management plans generated by private consultants.

It is likely that legislation will be introduced during the 2004 session to address the recommendations and concerns raised at the nutrient management summit.

For further information contact: Amanda M. Mock Phone: (410)946/(301) 970-5530

Environment and Natural Resources

Land Preservation: Where Are We Now and Where Are We Headed?

Of the 6.2 million acres of land in the State, approximately 1.2 million acres have been protected and 1.2 million acres have been developed, leaving about 3.8 million acres unprotected and undeveloped. State land acquisition programs were active in the late 1990s, but recent fiscal constraints have diverted a large portion of the funding for these programs to the general fund. Continuing budget constraints, combined with new land preservation guidelines developed by the Ehrlich Administration, will likely cause land preservation funding to resurface as an issue during the 2004 session.

Background

Maryland covers 6.2 million acres of land; almost 1.2 million acres have been protected through public ownership, State and county preservation programs, and the efforts of private organizations. The State's primary programs entrusted with preserving Maryland's open space and farmland include Program Open Space (POS), the Maryland Agricultural Land Preservation Program, Rural Legacy, and GreenPrint.

Current Status of Land Preservation

As shown in **Exhibit 1**, through June 2003, the State's land preservation programs, in conjunction with county preservation programs, private organizations, and public ownership, have collectively protected almost 1.2 million acres, or 19 percent, of the land in the State. Of the remaining land in the State, approximately 1.2 million acres, or 20 percent, have been developed, while approximately 3.8 million acres, or 61 percent, remain unprotected and undeveloped.

Exhibit 1

Total Acres Preserved in Maryland and Percentage of State Land Protected Through June 2003

	Acres	% of State (dry land)
Publicly-owned Land (Federal/State/Local)	662,516	10.68
Private Conservation Organizations	33,226	0.54
MALPF Easements	228,854	3.69
POS Easements	17,186	0.28
Rural Legacy	40,129	0.65
MET Easements	75,543	1.22

Exhibit 1 - continued

	Acres	% of State (dry land)
GreenPrint Easements	17,389	0.28
MHT Easements	9,583	0.15
County PDR/TDR Easements	103,423	1.67
Total	**1,187,849**	**19.16**

Key: MALPF: Maryland Agricultural Land Preservation Foundation; MET: Maryland Environmental Trust; MHT: Maryland Historical Trust; PDR/TDR: Purchase/Transfer of Development Rights
Source: Department of Natural Resources

Funding Affected by Recent Budget Constraints

The State's land preservation programs are primarily funded through the State's real estate property transfer tax, which is a 0.5 percent tax on all real property recorded in the State. In the late 1990s, the strong real estate market combined with a budget surplus enabled the State to protect significant amounts of land. In recent years, however, the General Assembly has used transfer tax revenues and land preservation program balances as a means to balance the State's operating budget. The Budget Reconciliation and Financing Act (BRFA) of 2002 (Chapter 440) and the BRFA of 2003 (Chapter 203) diverted, over several fiscal years, approximately $109.5 million and $116.0 million, respectively, in transfer tax revenues and land preservation program balances to the general fund. Chapter 203, Acts of 2003, also stipulates that 50 percent of the estimated transfer tax revenues for fiscal 2005 will go to the general fund. To partially offset these reductions, the fiscal 2004 capital budget included $32.1 million in general obligation (GO) bond funding for POS and $21.2 million in GO bond funding for MALPF.

Exhibit 2 shows available transfer tax revenues by fiscal year (from fiscal 2000 through 2004) and the distribution of those revenues between the programs and the general fund.

Exhibit 2
Transfer Tax Revenues
($ in Millions)

Fiscal Year	Available Transfer Tax Revenues	Amount to Programs	Amount to General Fund	% of Tax to General Fund
2000	97.8	92.5	2.8	2.9
2001	102.6	97.2	2.6	2.6
2002	121.7	99.4	19.3	15.9
2003	140.4	47.3	90.2	64.3
2004 (est.)	136.8	9.9	123.4	90.2
Total, 2000-2004	**$599.3**	**$346.3**	**$238.3**	**40.0%**

Note: Fiscal 2000 through 2003 revenues from Comptroller's actual receipts; may differ from estimated basis for appropriated budgets. Amount to programs does not include amounts used for administration.
Source: Department of Natural Resources

How Much Should the State Spend on Land Preservation?

In light of the continuing budget constraints, the General Assembly will likely revisit the issue of land preservation funding during the 2004 session. According to DNR, approximately 15,000 to 20,000 acres of land are lost to development each year. At an average easement cost of $2,500 per acre, preserving land at a rate commensurate with development costs the State approximately $50 million per year. December 2002 transfer tax estimates from the Board of Revenue Estimates (BRE) totaled $116.2 million in fiscal 2004; $115.6 million in fiscal 2005; $120.1 million in fiscal 2006; $123.7 million in fiscal 2007; and $126.8 million in fiscal 2008. BRE will release revised estimates in December 2003 that may be higher than the earlier estimates and could total $130 to $140 million annually over the next five years. How much should be allocated to the programs that the tax statutorily supports? How much should be diverted to the general fund? These questions cannot be answered until the State identifies a long-term goal for land preservation. The State needs to identify how much land should be left unprotected to accommodate future growth, how much land needs to be protected, and where its efforts should be focused. To date, these issues have not been thoroughly addressed. However, the Ehrlich Administration announced in October 2003 that it will develop new guidelines for land preservation; until then, almost all land acquisitions have been halted. The Administration's new guidelines will likely help shape the debate surrounding land preservation during the upcoming legislative session.

For further information contact: Lesley Cook/Malachy Rice Phone: (410) 946/ (301) 970-5510

State Government

Task Forces, Study Groups, and Special Legislative Committees

Various task forces and other entities have been established in recent years to study and make recommendations on issues and topics that are not otherwise covered in these issue papers.

Transportation Task Force

In June 2003, Governor Robert Ehrlich established, by executive order, the Transportation Task Force to recommend funding options for future highway, transit, airport, and port projects across the State. The task force was formed in response to concerns over transportation funding in light of increasing infrastructure needs. To date, the task force has reviewed the capital and operating budgets of all the modal administrations of the Maryland Department of Transportation (MDOT), including examining funded and unfunded system preservation and expansion needs, and has discussed the current administration's transportation priorities. The task force has also examined MDOT's sources of revenue, discussed methods for meeting capital budget shortfalls in the Maryland Transportation Authority, discussed the proposed construction of the InterCounty Connector highway, and heard comments from officials of local jurisdictions across the State on the impact of recent reductions in highway user revenues. The task force concluded its meetings on November 25 and agreed to forward to the Governor a menu of revenue options.

Virginia – Maryland – District of Columbia Joint Legislative Commission on Interstate Transportation

The leadership of the General Assembly created this commission in 2000 to foster regional cooperation among elected officials on transportation issues. The commission monitors developments in proposed interstate projects, traffic congestion studies, and federal aid. Pursuant to Chapter 632, Acts of 2001, Maryland commission members convened a study to assess whether a regional transportation authority would be feasible for the Washington metropolitan region. In February 2003, the commission released the study; it concluded that such an authority would work only if a regional funding source is developed or an interstate project has been approved because an authority cannot bypass funding or approval processes. The consultant who conducted the study recommended that the region improve its existing frameworks for collaborating on transportation projects and explore additional funding agreements for transit system expansion.

Department of Natural Resources Special Funds Workgroup

Established in 2002 pursuant to budget committee narrative, the Department of Natural Resources (DNR) Special Funds Workgroup was charged with reviewing the special funds administered by DNR and submitting recommendations for improving the management of those funds. The workgroup is required to submit its recommendations to the budget committees by December 1, 2003, to allow for consideration during the 2004 session. The workgroup is considering several legislative proposals for clarifying and improving DNR's special funds management. First, the workgroup is considering a proposal to codify the process by which DNR charges associated administrative costs to each special fund. Second, the workgroup is considering a proposal to establish a stakeholder workgroup to develop annual recommendations for changing the fees associated with DNR's special funds. Finally, the workgroup is considering a proposal that would make technical changes to the statutory provisions governing DNR's special funds in order to bring them up to date with current drafting guidelines.

Task Force to Study Moving Overhead Utility Lines Underground

Chapter 179, Acts of 2002, established the task force to make recommendations on how to facilitate and decrease the costs of burying overhead utility lines and how to improve the coordination between local governments and utility companies for construction projects along public roads. Initial meetings of the task force have focused on identifying obstacles and exploring the costs associated with burying lines. Preliminary findings suggest that the cost of moving overhead utility lines underground remains relatively high for a variety of reasons, and that while burying distribution lines largely solves the problem caused by falling trees and branches, it creates other concerns regarding long-term repair and maintenance. The task force is expected to report its findings to the Governor and the General Assembly by December 31, 2003.

Task Force on the Marketing of Grain and Other Agricultural Products

Created by Chapter 85 of 2003, the Task Force on the Marketing of Grain and Other Agricultural Products was convened to study the feasibility of re-establishing a grain export facility at the Port of Baltimore (POB) and to develop new strategies for marketing grain and other related agricultural products. The task force is responding to the need to find cost-effective storage and/or shipment options for grain grown in Central Maryland following the collapse in 2001 of the grain pier at the North Locust Point terminal at POB and the subsequent closure of the grain elevator operated at the terminal. The task force is assessing the current export market for grain products, examining the costs/benefits of re-establishing a grain export facility, and examining options for establishing transshipping centers in Central Maryland. The task force is also examining the potential for producing biodiesel fuel from soybeans grown in Maryland. In an effort to enable Central Maryland grain farmers to meet their storage/shipping needs in time for this fall's grain harvest, the task force has also convened a subcommittee to identify short-term transshipping options, including the establishment of a soybean receiving facility in

Carroll County. The task force is expected to conclude its work and report its findings by December 31, 2003.

Governor's Poultry Issues Action Team

Governor Ehrlich established the Poultry Issues Action Team by executive order on June 23, 2003. The action team was charged with assessing the economic condition of the poultry industry in the State, identifying its vulnerabilities, and evaluating solutions to promote economic growth. The action team met over half a dozen times with a variety of resource people and submitted a report to the Governor in October 2003. The report contains historical information about the industry as well as recommendations under the following categories: environmental, economic impact, land use/transportation, and marketing/labor. In an effort to strengthen the State's poultry industry, it is anticipated that the Administration will propose both regulatory and statutory changes to implement the group's recommendations, which may include targeted tax credit and loan programs, increased environmental research, improved agro-security measures, and changes to the Conservation Reserve Enhancement Program.

Task Force to Study the Economic Development of the Maryland Seafood and Aquaculture Industries

Chapter 535, Acts of 2002 established the Task Force to Study the Economic Development of the Maryland Seafood Industry and Aquaculture Industries. The task force consists of a seafood industry workgroup and an aquaculture industry workgroup. The seafood workgroup is reviewing the current methods of processing and marketing Maryland seafood and developing innovative methods to increase the demand for Maryland seafood both locally and nationally. The aquaculture workgroup is examining the viability of different types of aquaculture in the State and developing methods to encourage and foster aquaculture in the State. The task force must issue its final report, along with any recommendations for legislation, to the General Assembly and the Governor by September 30, 2004.

Governor's Commission on the Structure and Efficiency of State Government

The commission, with former Governor Marvin Mandel as its chairman, was established by executive order August 19, 2003 (Executive Order 01.01.2003.21). The commission is charged with examining the functions of independent agencies and commissions and making recommendations as to whether they should continue to function as independent entities. The 25 members of the commission are divided into four committees: Adjudicatory Functions, Environmental Programs, Independent Agencies, and Law Enforcement Agencies. The membership of the commission is diverse with public members, two former cabinet secretaries and three current members of the General Assembly. Governor Mandel has indicated that the focus of the commission is on "independent agencies that have no home" and are not in cabinet level departments. Efficiency in government, not saving money, is the primary objective of the commission's review. For example, currently there are 22 separate police agencies in State government that are outside the Maryland Department of State Police.

The commission released a draft report in November that recommended eliminating three agencies (the Health Claims Arbitration Office, the Maryland Energy Administration, and the State Board of Contract Appeals) and transferring or combining dozens of others. Four environmental programs (Conservation Reserve Enhancement, lead poisoning prevention, radiological health, and forestry) would move to another agency. The commission recommended centralizing policies related to the Chesapeake Bay under a newly created Bay Coordinator in the Governor's office and reconstituting a "Bay Cabinet" that would include the Secretary of Budget and Management and the director of the Governor's Washington, DC office. It also recommended unifying law enforcement agencies so that one force exists for all State facilities, another represents all modes of transportation, and one force works for colleges and universities. The Natural Resources Police would merge with Park Service Rangers. The commission further suggested that if slot machines are approved, a State Gaming Commission be created to oversee slots and the State lottery. Other recommendations of the commission would merge the Office of the Individuals with Disabilities (OID) and the Office of Deaf and Hard of Hearing into a Department of Disabilities and Special Needs. The department would also include other targeted groups – perhaps the Developmentally Disabled (DDA) population.

Several of the draft recommendations drew opposition during a public hearing, including the proposal to move the forestry division from the Department of Natural Resources to the Department of Agriculture and another to transfer the responsibility of building public schools to the Maryland Stadium Authority.

The commission is required to report its recommendations to the Governor by December 15, 2003.

Task Force on Broadband Communications Deployment in Underserved Rural Areas

Rural lawmakers sponsored Chapter 320 of 2003 to create a task force that would examine current broadband (high-speed) telecommunications access in rural areas of the State and recommend ways to improve broadband deployment where it is needed. The 20-member task force has developed a list of draft recommendations that include (1) joint purchasing for last-mile providers and local Internet Service Providers; (2) ensuring simple rights of way procedures for carriers; and (3) establishing a rural broadband coordinator. The task force will create a subgroup to review funding-related recommendations such as reviewing the existing sales and use tax on telecommunication and infrastructure and developing a State telecommunication fund using existing tax revenue. The task force must submit a final report by June 30, 2005.

Study Commission on Public Funding of Campaigns in Maryland

The 15-member Study Commission on Public Funding of Campaigns in Maryland was established by Chapter 169 of 2002 to analyze the State's current system of campaign finance. The commission is charged with determining whether the existing campaign finance system would benefit from modification in light of a recent trend towards public financing of elections among states.

The commission began meeting in the spring of 2002 with a series of information-gathering sessions which featured testimony from various interest groups, academics, and government officials. In December 2002, the commission voted to request an extension of its June 30, 2003, sunset date. The extension was granted by the Governor and legislature (Chapter 406 of 2003), and the commission is now preparing its recommendations for the 2004 session of the General Assembly.

While there has been no formal vote on the issue, a majority of the commission members have expressed support for full public financing of legislative elections in a manner similar to systems in use by Maine and Arizona. A system of public matching funds is preferred for statewide races. The total cost for this "mixed system" is estimated between $35,000,000 (excluding the gubernatorial race) and $70,000,000 (if gubernatorial candidates are included as eligible recipients of public funding in addition to the two statewide offices of Comptroller and Attorney General). The commission will submit its final recommendations by December 31, 2003.

Committee to Revise Article 27

The Committee to Revise Article 27 was appointed by the legislative leadership in 1991 to revise the State's criminal laws both substantively and stylistically. The committee is examining potential legislation to codify the common law offense of resisting or hindering an arrest, based on some lack of consistent enforcement based on the unit of prosecution and penalties for the common law offense that were addressed in a couple of recent opinions of the Court of Appeals. The proposal prohibits intentionally preventing or fleeing from a lawful arrest and clarifies that the unit of prosecution for the offense should be the prevented lawful arrest and not the number of law enforcement officers involved in the attempted arrest.

The committee is continuing its review of the substantive issues raised by the Criminal Law Article Review Committee relating to unresolved questions or problems resulting from the nonsubstantive revision of the Criminal Law Article. Among the issues for consideration are amendments to provisions dealing with child kidnapping, extortion, false statements, escape, and interference with sporting events.

Council on Parental Relinquishment of Custody to Obtain Health Care

Created by Executive Order 01.01.2003.02, the Council on Parental Relinquishment of Custody to Obtain Health Care Services was charged with identifying alternatives to the practice of requiring parents who have significant and complex mental health needs and/or developmental disabilities to relinquish the custody of their children in order to access needed services.

The council issued its final report in September 2003. Major recommendations center on (1) coordinating information and referral services and data collection activities among the subcabinet for Children, Youth, and Families' agencies; (2) targeting resources in the subcabinet agencies to families caring for special needs children; (3) implementing a wraparound case rate for provider reimbursement; (4) applying for a federal Medicaid waiver and using the Medicaid rehabilitation option to allow more children to be served in the community; (5) designating interagency teams in each jurisdiction to respond to children at risk of custody relinquishment; and (6) conducting statewide training of child-serving agency personnel to assure consistent implementation of State policy.

According to the Governor's Office of Children, Youth, and Families, about a third of the recommendations are in the process of being implemented, another third have been folded into the planning process for Chapter 282 of 2002, and the remaining third are awaiting further direction from the Governor. Chapter 282 requires the subcabinet to develop a plan by December 1, 2003, to improve access to services for children with special needs, develop community-based resources for children with intensive needs and children at risk of residential placement, and reduce the number of children placed outside of their home communities.

Governor's Commission on Minority Business Enterprise Reform

In November 2002, the Office of Legislative Audits published a Performance Audit Report on the Minority Business Enterprise (MBE) Participation Program. The audit disclosed problems with the oversight of the MBE Program and the monitoring of MBE participation in public contracts. In particular, the audit raised significant concerns about information reported by State agencies regarding MBE participation in public contracts because the reports were based on unsupported or inaccurate data.

On June 12, 2003, Governor Robert L. Ehrlich issued Executive Order 01.01.2003.16 creating the Governor's Commission on Minority Business Enterprise Reform (the commission). The commission is required to (1) review MBE practices and procedures; and (2) use existing studies, data, and reports to examine MBE issues, including barriers to MBE certification, access to capital and opportunities, MBE availability, monitoring and compliance, and program consolidation.

After finishing its review and examination, the commission is likely to recommend legislative and administrative remedies to problems facing the MBE Program. Recommended remedies likely will address (1) making reporting requirements and standards, and thus data relating to the MBE Program, more uniform; (2) holding State agencies more accountable for data reported on the MBE Program and for meeting MBE goals established in State law; and (3) requiring data reported to include actual payments made to MBE contractors on State contracts, not just the amount of contract awards to MBE contractors. The commission must issue its final report to the Governor by December 31, 2003.

Governor's Commission on Housing Policy

As created by Executive Order 01.01.2003.10, the Governor's Commission on Housing Policy is charged with recommending specific and measurable actions to increase and preserve quality affordable housing in all communities in Maryland. While legislation was introduced early in the 2003 session to create a task force for similar purposes, the legislation was withdrawn after the executive order was signed in March. The Governor made appointments to the 21-member commission in early September, designating Victor L. Hoskins, Secretary of Housing and Community Development, as chairman. The President of the Senate and the Speaker of the House each appointed one member to the commission. Five other State officials were appointed by the Governor to lead the five working subcommittees of the commission which will focus on the following issues: accessibility for individuals with disabilities, affordable housing, community revitalization, land use, and senior citizens. As a whole, the membership represents a broad spectrum of housing advocacy groups, public housing authorities, legislators, State and local government officials, mortgage companies, realtors, homebuilders, and real estate developers.

The commission has held two full-committee meetings since the members were appointed; the subcommittees will start meeting this fall. Throughout 2004, the full committee and the subcommittees are scheduled to meet in alternate months. The commission's interim report to the Governor is due September 30, 2004, and the final report is due December 31, 2004.

For further information contact John F. Rixey, Jr./Linda L. Stahr Phone: (410) 946/(301) 970-5510

State Government

Homeland Security

Heightened attention to security as a result of the September 11, 2001 terrorist attacks has resulted in the creation of the Governor's Office of Homeland Security and additional State and federal funds for emergency management and combating bioterrorism.

Overview

Homeland security preparedness encompasses four basic functions: (1) prevention; (2) preparation; (3) response; and (4) recovery. **Exhibit 1** provides an overview of the kinds of activities that are involved in each function and identifies the agencies and levels of government that bear the primary responsibility for each function. As the table demonstrates, homeland security involves a myriad of government agencies, private citizens, and non-governmental entities like hospitals and relief organizations. The specific roles of each group are discussed in greater detail below.

Exhibit 1
Functions and Activities of Homeland Security Preparedness

Function	Example Activities	Responsibilities	
Prevention	Investigation Intelligence gathering Resource allocation Cooperative relationships with federal and State officials	**Federal** **State**	Department of Defense, Intelligence Services, Department of Homeland Security, Department of Justice, Department of Health and Human Services Governor’s Office of Homeland Security, Joint Federal/State Projects, State Police
Preparation	Planning Exercises and training Equipment procurement Establishment of lines of communication	**Federal** **State** **Local**	Departments of Homeland Security, and Health and Human Services MEMA, State Police, DHMH, Other State Agencies, Volunteer Groups Local Police, Fire Departments, Local Health Departments, Local Emergency Management Agency, hospitals, WMATA
Response	On-scene management Medical care Evacuation Coordination of first responders Distribution of accurate and timely information	**Federal** **State** **Local**	Federal involvement depends on the nature of the incident and the assets involved MEMA, State Police, National Guard Police, Fire Department, Local Health Departments, Hospitals, Local Emergency Management Agency, Volunteer Groups
Recovery	Rebuilding Evaluating responses Revising plans and training	**Federal** **State** **Local**	FEMA MEMA Police, Fire Department, Local Health Departments, Hospitals, Local Emergency Management Agency, Volunteer Groups

Source: Department of Legislative Services

Prevention is primarily a federal function and largely involves international relations activities, including (1) monitoring terrorist groups and international terrorist activity; (2) working with foreign countries in gathering intelligence; and (3) engaging in military action when necessary. The State's role is to properly adjust and prepare its capabilities and readiness based on the information the federal government provides regarding the threat level and risk assessments. One significant prevention element that the State does provide is the newly established State Police intelligence center.

Preparation is primarily a State and local government function. The federal government provides funding for training and exercises, but it is the State through the Maryland Emergency Management Agency (MEMA), the Department of Health and Mental Hygiene (DHMH), and other appropriate agencies that design and conduct the training and exercises involving State and local responders. The State agencies also evaluate and work to improve homeland security results.

First response is almost always going to be a local function. State and federal response units may eventually get involved, but ultimately an incident takes place in a local jurisdiction, and the local responders will be the first to provide emergency services of all kinds.

The process of recovery, rebuilding, and restoring is primarily a local function, although funding is often available from the federal and State emergency management agencies.

Maryland has an inordinate number of risk challenges for its geographical size, given its proximity to the national capital. Federal experts have developed a formula for risk assessment, which, for security reasons, is not public information. In Maryland, MEMA has developed a master target list and reports that there are over 1,400 targets in the State that are considered at some risk.

Organization

Four State agencies undertake most of the homeland security responsibilities for Maryland: the newly established Governor's Office of Homeland Security (GOHS); the Maryland Emergency Management Agency (MEMA); the Department of Health and Mental Hygiene (DHMH); and the State Police.

Governor's Office of Homeland Security

On June 23, 2003, Governor Robert Ehrlich signed Executive Order 01.01.2003.18 establishing the Governor's Office of Homeland Security. GOHS serves as one of the Governor's primary sources of information and advice on homeland security matters. In addition to being a conduit of information to the Governor, GOHS works to maximize the amount of federal funding the State receives and assists State and local agencies in applying for grants for homeland security. GOHS also coordinates State resource use to ensure that Maryland's homeland security funding is being spent as effectively and efficiently as possible. Further, GOHS works with federal, State, and local governments to eliminate redundant procurements and the duplication of efforts, and generally to ensure that all priorities are addressed. The director reports directly to the Governor.

Maryland Emergency Management Agency

The Maryland Emergency Management Agency is responsible for coordinating the State response to any major emergency or disaster. The emergency response function includes:

- supporting local governments;
- coordinating FEMA assistance;
- researching, writing, implementing, and reviewing emergency plans and procedures; and
- training emergency personnel and conducting statewide exercises.

The Domestic Preparedness Division within MEMA originally was formed as the State Anti-Terrorism Unit in June 1999 and functions as MEMA's anti-terrorism planning division.

Department of Health and Mental Hygiene

The Department of Health and Mental Hygiene is responsible for the planning, preparation, and response to incidents that have a health impact. DHMH oversees vaccine inventories, disease tracking and surveillance, volunteer networks of medical professionals, and laboratory work. DHMH is a significant recipient of federal homeland security funds and also serves as a major pass through agency for funding local hospitals and health boards.

Maryland State Police – Homeland Security and Intelligence Bureau

The Homeland Security and Intelligence Bureau operates 24-hours a day, seven-days a week, and works with law enforcement agencies and private and public organizations to try to minimize the threat of potential terrorist attacks.

The bureau also operates the new Maryland Coordination and Analysis Center (MCAC) to provide analytical support for federal, State and local agencies involved in law enforcement, public health and welfare, public safety, and homeland defense in Maryland. MCAC coordinates intelligence to reduce duplicate and contradictory reporting and to identify patterns and trends specific to Maryland that may not be apparent outside of a coordinated analysis.

Other Entities

There are many other agencies, task forces, and councils involved in homeland security. These include:

- Maryland Department of General Service;
- Maryland Department of Environment;
- Maryland Department of Agriculture;
- Maryland Institute for Emergency Medical Service Systems;
- Anti-Terrorism Task Force;
- Joint Terrorism Task Force;
- Maritime Security Group;
- Terrorism Forum;
- Maryland Security Council;
- Governor's Emergency Management Advisory Council;
- National Capitol Region Senior Policy Group; and,
- Volunteer Organizations.

Federal Homeland Security Funds Have Significantly Increased

In federal fiscal 2001 and 2002, Maryland received $61.2 million from the federal government for homeland security activities. (See **Exhibit 2**.) Most of the grants received by MEMA are "pass through" grants in that the money is re-distributed to other State agencies or local jurisdictions.

The total federal fiscal 2003 appropriation for Maryland homeland security is not yet known. Several of the awards appropriated in either the federal 2003 regular budget or the supplemental are competitive grants and depend on the appropriate State agencies applying for and receiving grants. Several of the appropriations are multi-year grants, and the exact split over the years has not been determined. However, as of October 1, 2003, Maryland has or will receive $84 million, plus an undetermined share of the appropriation for the national capital region.

Exhibit 2

Homeland Security Aid in Fiscal 2001, 2002, and 2003

Grantor	**Recipient**	**Amount (FFY)**		**Allowed Uses of Funds**
		2001 and 2002	**2003**	
Dept. of Health and Human Services	DHMH	$ 19,300,912[1]	$ 27,655,228	Planning, surveillance, biological labs, information technology, and training
Dept. of Justice – Byrne Grant	State Police	11,005,000	0	Training, equipment, communications
Federal Emergency Management Agency	MEMA	7,731,000	38,600,000[2]	Grants for emergency preparedness, planning, training, and communications
Dept. of Justice – Byrne Grant	Montgomery and Prince George's Counties	16,436,000	0	Reimbursement for 9/11/01 related expenses
Office of Domestic Preparedness (Department of Homeland Security)	Baltimore Metropolitan Area	0	10,900,000	Equipment, training, exercises, planning, and operations
Various Departments	Other State and Local Agencies	6,689,716	6,873,698	
Total		**$61,162,628**	**$84,028,926**	

Note: Numbers may not sum to total due to rounding.

Notes:
[1] DHMH also received several one-time only event specific grants totaling approximately $12 million.
[2] The Federal Emergency Management Agency was merged into the federal Department of Homeland Security and now gives its grants in bulk.

Source: National Conference of State Legislatures, various agencies referenced, MEMA – Domestic Preparedness Division, and (Maryland) Office of Homeland Security

Conclusion

Since the September 11, 2001, terrorist attacks, Maryland policymakers have given increased focus to the homeland security needs of the State. The appropriate State and local government agencies have been involved with planning, training, procuring equipment, and reorganizing their functions in ways that reflect the new reality of our security requirements. The majority of the funding for these efforts has come from the federal Department of Homeland Security. However, there are still other financial needs that must be met. The need for first responders to be able to communicate is unquestioned and is a difficult and expensive problem to solve. According to security officials, this is the most significant priority to be addressed over the next few years and will take extensive federal, State, and local cooperation.

Another major priority is the command structure for emergency response. Currently, the command structure is decentralized. All the major agencies involved in homeland security report directly to the Governor and in any given emergency the command structure below the level of Governor is decided on a case-by-case basis. The main reason for this approach is that each emergency may require a different response and involve the expertise of any of the State agencies involved in homeland security functions.

For further information contact: Brian Baugus/Stacy Goodman Phone: (410) 946/(301) 970-5510

State Government

Sale of State Assets

The State's current fiscal imbalance has prompted the Governor to conduct an inventory of State-owned real property that could be sold. Financial assets of certain business financing and housing programs are also potentially marketable. Regulations governing such asset sales are relatively sparse, meaning that processes for evaluating and selling State assets must be developed. The costs and benefits, both short- and long-term, of such sales must be carefully evaluated.

Sale of State Assets

Some commentators have suggested selling excess State property to generate revenue to partially address the current budget shortfall. Two types of assets could hold relatively large value if sold: real property and financial assets. The rationale is that certain assets can provide greater value to the State when placed with another entity to be held or resold. The value received from a sale may come in various forms, such as through financial income, reduced administrative functions, or increased property tax receipts attained by placing property back on the tax rolls.

State Real Property

Early in his term, Governor Robert Ehrlich directed the Maryland Department of Planning (MDP) to identify State-owned property that could be sold. Although the State Finance and Procurement Article requires the Department of Budget and Management and the Department of General Services (DGS) to adopt regulations governing the transfer of State real or personal property, regulations have only been adopted governing the disposition of personal property. The departments have adopted no regulations governing the disposition of real property.

Using records of the State Department of Assessment and Taxation, MDP identified all State-owned real property. Next, MDP worked with State agencies to identify which agency actually owns each property, whether each property is in use, the actual use of each property, and any plans for future use of each property. Currently, MDP has completed this process for 86 percent of State agencies but only 9 percent of State-owned parcels. The Department of Natural Resources (DNR) and the Maryland Department of Transportation (MDOT) own most of the remaining parcels. MDOT has evaluated most of its parcels and is focusing on selling excess parcels. DNR has provided MDP with information on some properties and is gathering information on its remaining parcels.

After determining what property each agency owns and which property is not in use, MDP will act as a clearinghouse. MDP will identify the best use of each property, including whether the property should be sold. MDP will then make recommendations to the appropriate agencies and the Board of Public Works as to the best use of each property. If MDP determines and the Board of Public Works and appropriate agency agree that the best use of a property is to sell it, MDP and DGS will work to market and sell the property. The final sale must be approved by the Board of Public Works.

MDOT and the University System of Maryland will handle the sales of their excess property. It appears that the University System of Maryland has few excess properties. MDOT's Office of Real Estate Development (ORED) is handling its sale of excess real property. ORED developed a web site to market excess properties, as well as other property that may hold some economic development potential near other MDOT facilities. As of August 2003, the web site listed 70 excess properties. Just as with other agencies, MDP acts as a clearinghouse for the sale of MDOT property by polling other interested parties such as State agencies and local governments. However, MDOT will handle the marketing and sales. The final sale must be approved by the Board of Public Works.

Disposition of Proceeds

Generally, if cash is received as payment, it must be deposited into the State Annuity Bond Fund Account for the payment of principal and interest on outstanding bonded indebtedness. However, if the property was originally acquired with money from a special fund, the cash must be deposited into the special fund. For example, the proceeds of the sale of property acquired by the Transportation Trust Fund must be deposited into the Transportation Trust Fund. In addition, if cash is received in exchange for transfer of a capital asset, other than real property (e.g., land patents), the cash may be paid into the State Treasury. If real or personal property is received in exchange for the real or personal property of the State or a unit of State government, the property received shall be held and accounted for in the same manner as other property under the control of the unit.

Exceptions

Maryland law provides the following exceptions to these rules for certain sales or exchanges by the University System of Maryland, the Developmental Disabilities Administration and Mental Hygiene Administration of the Department of Health and Mental Hygiene, and the Department of Natural Resources:

- If the University System of Maryland sells real property, proceeds of the sale may not be deposited into the Annuity Bond Fund Account and instead, may only be used, with the approval of the Board of Public Works, for the purchase or improvement of university property and facilities.

- The proceeds of the sale or long-term lease of property and equipment of a Developmental Disabilities Administration facility or a Mental Hygiene Administration facility must be deposited into the Community Services Trust Fund.
- The Department of Natural Resources may dispose of any existing structure on property acquired by the State for DNR's use if the property is valued at $2,500 or less. The proceeds must be credited to the Natural Resources Property Maintenance Fund.

In addition, if a property was purchased using federal funds or for a federally-funded project, such as a highway project, the federal government requires that these funds be returned to the federal government. If a state sells or leases federally funded infrastructure assets, the state must repay the depreciated value of the federal grant.

Special rules, including time frames and potential purchasers, apply to the disposition of State Highway Administration property no longer needed for public purposes, such as acquired right-of-way. In addition, the release of a lot from an agricultural land preservation easement is governed by the requirements of the Agricultural Land Preservation Program.

Sale of Financial Assets

Although some aspects of the sale of financial assets are governed by State statute or regulation, the primary obligations that must be met prior to sale are those related to the contractual agreements, requirements, and disclosures of the instruments themselves. Generally, the disposition of any proceeds must go to the State Treasury, but prior to that happening – especially for securitized assets[1] – a process must be defined that will satisfy investors, insurers, credit rating agencies, and possibly obligations under federal law. If the sale of a particular asset is determined to be legally possible, and the decision is made to liquidate, then the immediate financial gain to the Treasury must be weighed against the long-term impact to the budget and the policy implications associated with divestiture to arrive at the net value of the transaction.

Some assets, such as many of the business financing programs that the Department of Business and Economic Development administers, may be particularly challenging – or impossible – to liquidate. In addition to reversion clauses that forgive portions of loans if certain goals are met, a loan portfolio may be structured on a revolving model so that the net gain on previous loans allows the agency to continue making new loans going forward and possibly cover administrative costs. The securitization of such portfolios, if possible at all, could prove to hold marginal immediate value for the State and even less net value in the long-term, by effectively starving the program of ongoing funds.

[1] Securitization is bundling a group of loans and issuing bonds on the group. It combines the risk and estimated payoffs of individual loans into one obligation – the bond – for sale to investors.

An example of a financial asset under consideration for sale is the Maryland Housing Fund (MHF). MHF was established in 1971 to provide residential mortgage insurance primarily for discount rate loans made by the State's Community Development Administration (CDA). CDA bundles the loans it makes and sells investment bonds on the capital markets to finance ongoing operations. These mortgage bonds receive their own credit rating and are backed only by the reserves of MHF; the faith, credit, or taxing power of the State are not pledged as guarantees. To help balance the fiscal 2004 budget, Chapter 203 of 2003 (Budget Reconciliation and Financing Act of 2003) transferred $10 million from the MHF reserves to the general fund.

As a loan insurer, MHF's activities are subject to statutory and regulatory requirements as well as to insurance agreements, bondholder disclosures, and credit rating agency evaluation. If the State wished to liquidate MHF – in addition to making possible statutory changes governing use of monies under Article 83B, § 3-203 – a number of actions would have to take place, including: a deal would have to be structured with another insurer to guarantee the loans going forward; contracts, agreements, and disclosures would have to be amended to reflect the changes made; and a credit rating agency (Moody's, in the case of MHF) would then analyze the entire restructuring and re-evaluate the credit risk and, therefore, the bond rating. The program's ability to insure future loans would be impaired. The immediate budgetary impact of such an action would depend on a variety of factors, while the long-term impacts – from both a budgetary and a policy perspective – would be exceptionally difficult to quantify.

For further information contact: Dea Whayland-Daly/Mitchell J. McCalmon (410) 946/(301) 970-5350

State Government

Task Force to Study Efficiency in Procurement

The Task Force to Study Efficiency in Procurement has completed its review of State procurement and approved 20 recommendations for its final report. The task force is still meeting and will act on an additional 11 recommendations and present its final report to the Governor and General Assembly prior to the 2004 legislative session.

Task Force Origin and Charge

The task force, created by Chapter 386 of 2003, is comprised of 21 members from the public and private sectors. Public sector representatives include two members from the House of Delegates; two Senators; seven ex-officio members from Executive Branch agencies; a representative from the Board of Public Works; and the State Treasurer. Private sector representatives appointed by the Governor were selected from various industries, including commodities; security; information technology; and human services.

The task force organized its work within four subcommittees. The Efficiency Subcommittee reviewed market-based procurement reform, privatization, performance-based contracting, green buildings, and accountability of State officials. The Organization Subcommittee reviewed both the overall structure of the procurement system in Maryland and the uniform application of current procurement laws. The Dispute Resolution Subcommittee reviewed the current administrative dispute resolution structure and possible alternative dispute resolution processes that may increase fairness in the system. The Information Technology Subcommittee reviewed strategies and policies to improve contract development, terms and conditions, and the effectiveness of project management in State government information technology projects.

Subcommittees interviewed State agency personnel, representatives from other states and the federal government, private sector vendors, contractors, and attorneys to develop background data and inform their recommendations. Each subcommittee developed recommendations that then were forwarded to the full task force for action. As of December 1, 2003, the task force had acted upon half of the recommendations that were proposed by the subcommittees and will act on the remainder of the recommendations prior to the 2004 legislative session.

Task Force Recommendations Approved

The task force has approved recommendations in the areas listed below. The final report of the task force to the Governor and General Assembly will provide background detail and specific courses of action related to each recommendation.

- Gain-Sharing – State agencies should be encouraged to recognize and reward State employees for innovative ideas and suggestions.

- Electronic Commerce – State agencies should be encouraged to use available technology, including the use of commercial off-the-shelf systems, in appropriate circumstances.

- Outsourcing/Privatization – State agencies should continue to look for opportunities to make their operations more efficient through appropriate outsourcing or privatization.

- State Assets – State agencies should consider privatization of State assets where appropriate.

- Share-in-savings – State agencies should consider arrangements that compensate the contractor on the basis of performance, in appropriate circumstances.

- "Whistleblower" Procedures – The State should implement a program to provide a financial incentive to report fraud in procurement.

- Public-private Partnerships – State agencies should be encouraged to further explore public-private partnerships within the restrictions of the procurement law.

- Participation in Drafting Specifications – The Ethics Law should be clarified to permit agency personnel to meet with prospective vendors individually to learn of capabilities, new techniques or innovations, or to receive suggestions for possible inclusion in a future procurement.

- Environmentally Friendly Buildings – Procurement officers should be authorized to consider the additional advantages/savings of high-performance buildings.

- Centralization Study – The Executive Branch should conduct a study of the efficiencies that can be gained with some added centralization of the State's procurement structure.

- Training Program – The State should establish a procurement training program for the uniform training of State procurement officers.

- Executive Branch Procurement Policy Office – The Executive Branch should create an entity that complements the Board of Public Works and the Procurement Advisory Council in setting procurement policy with the aim toward coordination, standardization, and efficiency among Executive departments and agencies.

- Legislative Review and Revision of Procurement Code – A joint committee of the General Assembly should be established to propose substantive changes to update, clarify, and reorganize State procurement law, written over 20 years ago.

- Code Clarification – A nonsubstantive review of State procurement law should be undertaken to consolidate in one place the various provisions of the procurement law that now are scattered throughout various articles of the Annotated Code.

- Centralization Study – Business Process Re-engineering – The State Chief Information Officer should review the statewide management of information technology assets and recommend consolidation and economy of scale enhancement strategies.

- Delegated Authority – Control agencies should consider increasing the level of delegation, based on training and experience at individual user agencies.

- State Board of Contract Appeals – Membership and Terms – To strengthen the board's expertise and improve its efficiency, a screening panel should be created to recommend nominees to the Governor for appointment to the board and the terms of members should be extended to 10 years.

- State Board of Contract Appeals – Small Cases Limits – The expedited case limit should be raised to $50,000, and the accelerated case limit should be raised to $100,000.

- State Board of Contract Appeals – Small Cases Appellant Pilot – A two-year pilot program should be implemented that permits a principal of the contractor/appellant to represent that company in an expedited case, even if the principal is not a lawyer.

- Contract Clauses/Accountability – A review and evaluation of existing contract clauses in State procurements should be undertaken.

Recommendations Still Requiring Task Force Action

Prior to the 2004 session, the task force will meet again to determine its position on recommendations relating to increasing the prevailing wage; reverse online auctions; advertising restrictions; unsolicited proposals; revenue-generating contracts; re-establishment of the competitive re-engineering pilot program; prequalification of vendors; the State's preference for competitive sealed bids; jurisdiction and procedure rules for the State Board of Contract Appeals; and an Alternative Dispute Resolution pilot program.

For further information contact: Daniel P. Tompkins Phone: (410) 946/ (301) 970-5510

Local Government

State Aid to Local Governments

State aid to local governments accounts for about 26 percent of total State expenditures (general and special funds) and 37 percent of State general fund expenditures. The rate of growth in State aid continues to exceed the rate for most State agencies due primarily to the implementation of the Thornton funding requirements for public schools.

State Aid Increases in Fiscal 2005

State aid to local governments is projected to total $4.7 billion in fiscal 2005, representing a $463.5 million or 11.0 percent increase over the prior year. Direct aid is projected to increase by $442.9 million or 11.6 percent and retirement payments made-on-behalf of local governments are projected to increase by $20.6 million or 5.0 percent. Public schools will receive 82 percent of the projected increase in State aid, representing an additional $362.2 million in direct aid and $19.6 million in teachers' retirement payments. County and municipal governments account for 15 percent of the projected State aid increase, representing a $70.9 million funding increase. State aid to local health departments, libraries, and community colleges will receive modest aid increases in fiscal 2005. The projected increase in State aid in fiscal 2005 is significantly higher than the rate in prior years. For comparison purposes, State aid increased by 6.1 percent in fiscal 2003 and 2.5 percent in fiscal 2004. Since fiscal 1995, State aid has increased at an average annual rate of 6.7 percent. **Exhibit 1** shows the change in State aid by governmental entity, and **Exhibit 2** shows the change in State aid by major aid programs.

Exhibit 1
State Aid to Local Governments – By Governmental Entity
($ in Millions)

Governmental Entity	FY 2004	FY 2005	Difference	% Change
Public Schools	$3,316.3	$3,698.2	$381.8	11.5%
County/Municipal	613.2	684.1	70.9	11.6%
Community Colleges	174.9	183.1	8.2	4.7%
Local Health	60.4	62.1	1.7	2.8%
Libraries	49.2	50.2	0.9	1.9%
Total	**$4,214.2**	**$4,677.7**	**$463.5**	**11.0%**
General Funds	3,806.4	4,201.4	394.9	10.4%
Special Funds	407.7	476.3	68.6	16.8%

Source: Department of Legislative Services

Exhibit 2
State Aid to Local Governments – Major Programs
($ in Millions)

	FY 2004	FY 2005		Difference	% Change
Public Schools					
Foundation	$2,013.4	$2,153.6		$140.2	7.0
Compensatory Aid	350.8	476.4		125.5	35.8
Limited English Proficiency	38.9	54.3		15.4	39.7
Student Transportation	167.0	175.7		8.7	5.2
Special Education – Formula	116.3	155.6		39.4	33.9
Special Education – Nonpublic	104.0	115.2		11.3	10.8
Guaranteed Tax Base	0.0	17.8		17.8	
County/Municipal					
Highway User Revenues	358.6	418.3		59.7	16.6
Disparity Grants	105.8	92.3		(13.5)	(12.8)
Police Aid	61.1	62.4		1.3	2.1
Electric Utility Tax Credit	26.2	30.6		4.4	16.8
Program Open Space	19.1	20.6	*	1.5	7.7
911 Grants	5.3	13.0		7.7	144.3
Community Colleges					
Cade Formula	142.7	144.2		1.5	1.0
Local Health Departments					
Local Health Formula	60.4	62.1		1.7	2.8
Libraries					
Library Formula Aid	27.3	27.7		0.5	1.7
State Library Network	13.9	14.2		0.2	2.9

*Does not include $1.5 million special grant to Baltimore City.

Source: Department of Legislative Services

Public School Funding Accounts for Most of the State Aid Increase

Funding for public schools accounts for most of the increase in State aid (82 percent). Public schools will receive $3.7 billion in fiscal 2005, representing a $381.8 million or 11.5 percent increase over the prior year. The anticipated increase in State aid reflects the implementation of Chapter 288 of 2002, commonly referred to as the Thornton Legislation.

Chapter 288 enhances per pupil State aid through the foundation program, enhances per pupil funding for three special needs populations, provides incentives to low wealth counties to contribute more than the minimum required funding, and phases out certain education programs over a five-year period. Funding in the five major funding formulas outlined in Thornton is anticipated to increase by $338.3 million, or 13.4 percent in fiscal 2005.

County and Municipal Governments Will Realize Increased State Support

County and municipal governments are projected to receive $684.1 million in fiscal 2005, representing a $70.9 million or 11.6 percent increase. The largest increase occurs in local highway user revenues which are projected to total $418.3 million. This is a $59.7 million increase over the fiscal 2004 legislative appropriation. This estimate takes into account the transfer of $51 million in local highway user revenues to the State's general fund as required by Chapter 203 of 2003.

Funding for Program Open Space in fiscal 2005 is projected to total $22.1 million, which includes the $1.5 million special grant to Baltimore City. This projection assumes that 50 percent of transfer tax revenues will be diverted to the State's general fund. In fiscal 2004, the Budget Reconciliation and Financing Act of 2003 redirected 100 percent of transfer tax revenues to the general fund. General obligation bond funding in the amount of $19.1 million was used to offset the funding decrease in fiscal 2004. The fiscal 2005 projection does not assume any additional general obligation bond funding for Program Open Space.

State aid through the 911 program is projected to increase by $7.65 million in fiscal 2005. This increase is due to legislation (Chapter 451 of 2003) that increased the State telephone system accessible service subscriber fee from 10 to 25 cents per month. The additional funds will be used to enhance services and support expansion of the 911 systems in local jurisdictions.

Funding for disparity grants is projected to decline by $13.5 million in fiscal 2005. This decrease is due to the continual decline in net taxable income throughout the State, which has reduced the disparity among counties, and the elimination of $9.2 million in discretionary grants provided in fiscal 2004. Funding for the disparity grant program is projected to total $92.3 million in fiscal 2005, down from $105.8 million in fiscal 2004.

Modest Increases in Community College, Library, and Health Funding

State aid to local community colleges, libraries, and local health departments is projected to experience modest growth in fiscal 2005. Funding under the Community College Cade formula is projected to increase by 1.0 percent to $144.2 million in fiscal 2005. This reflects a 1.5 percent increase in student enrollment and a 6.1 percent decrease in the per pupil funding level, which results from lower State support for public institutions of higher education in the previous year. The library aid formula will total $27.7 million in fiscal 2005, representing a 1.7 percent increase over the prior year, resulting from annual population growth. Funding for the

State library network will total \$14.2 million. Local health grants are projected to total \$62.1 million in fiscal 2005 which reflect \$52.8 million in formula aid and \$9.3 million in annualized salary adjustments.

State Paid Retirement Costs Increase

Retirement payments for teachers, librarians, and community college faculty will increase by \$20.6 million or 5.0 percent in fiscal 2005. This increase reflects a higher salary base rate for fiscal 2005. Retirement costs for fiscal 2005 are based on a \$4.6 billion payroll and a 9.35 percent retirement contribution rate.

Local Government

Local Tax and Salary Actions

Local jurisdictions made many changes to their tax rates in fiscal 2004. These changes impacted property taxes, income taxes, recordation taxes, transfer taxes, admissions and amusement taxes, and hotel/motel taxes. In addition, most local jurisdictions provided salary enhancements to their employees in fiscal 2004.

Local Government Tax Rates

Local tax rates increased in thirteen jurisdictions in fiscal 2004, with six counties increasing two or more taxes. The number of jurisdictions increasing their tax rates in fiscal 2004 was higher than in prior years as shown in **Exhibit 1**. **Exhibit 2** shows the local tax rates for fiscal 2003 and 2004.

Exhibit 1
Number of Counties Changing Local Tax Rates

	FY 2000		FY 2001		FY 2002		FY 2003		FY 2004	
	▲	▼	▲	▼	▲	▼	▲	▼	▲	▼
Property	3	3	9	2	5	3	1	5	4	1
Income	2	2	7	1	4	0	0	0	6	0
Recordation	2	0	1	0	1	0	2	0	5	0
Transfer	0	0	0	0	0	0	0	0	1	1
Admissions/Amusement	0	0	2	0	0	0	1	0	2	0
Hotel/Motel	2	0	3	0	0	0	0	0	1	0

Note: ▲ represents tax rate increase; ▼ represents tax rate decrease.
Source: Department of Legislative Services Annual Tax Survey

Property Tax Rates

Three counties (Allegany, Anne Arundel, and Dorchester) raised their general property tax rates in fiscal 2004, while one county (Wicomico) lowered its rate. In Montgomery County, the general property tax rate was decreased, but the impact was offset by increases in other property tax rates. In Prince George's County, the pre-TRIM debt service tax was eliminated, but the impact was offset by an increase in the Maryland-National Capital Park and Planning Commission tax rate resulting in an overall rate increase for county taxpayers.

Local Income Tax Rates

Six counties (Calvert, Carroll, Howard, Montgomery, Prince George's, and Talbot) increased their local income tax rates for calendar 2004. Three counties (Howard, Montgomery, and Prince George's) are now implementing an income tax rate of 3.2 percent which is the maximum rate allowed by State law.

Recordation Tax Rates

Five counties (Allegany, Caroline, Carroll, Dorchester, and Wicomico) increased their recordation tax rates in fiscal 2004. Local recordation tax rates range from $2.20 per $500 of transaction in Prince George's County to $5.00 in Calvert, Caroline, Carroll, Charles, Dorchester, and Frederick counties. All counties have a recordation tax.

Transfer Tax Rates

Washington County imposed the transfer tax for the first time in fiscal 2004 with the rate set at 0.5 percent. Dorchester County lowered its transfer tax rate from 1.0 to 0.75 percent effective July 1, 2003. Currently, 16 counties and Baltimore City impose a transfer tax. Local transfer tax rates range from 0.2 percent in Allegany County to 1.5 percent in Baltimore City and Baltimore County. In addition, Cecil County imposes a $10 charge per deed. Calvert, Carroll, Charles, Frederick, Somerset, and Wicomico counties are the only jurisdictions without a transfer tax.

Admissions and Amusement Tax Rates

Calvert and Dorchester counties increased their admissions and amusement tax rates in fiscal 2004. Calvert County raised its rate from 1.0 to 10.0 percent effective September 1, 2003. Dorchester County raised its rate from 0.5 to 4.0 percent effective July 1, 2003. Caroline County is the only jurisdiction without an admissions and amusement tax.

Hotel and Motel Tax Rates

Calvert County imposed a 5.0 percent hotel/motel tax rate beginning in fiscal 2004. Four counties (Caroline, Carroll, Frederick, and Harford) do not impose a hotel/motel tax.

Other Local Tax Rates

Montgomery County increased its fuel, energy, and telephone taxes in fiscal 2004. In Frederick County, the property tax rate dedicated to public safety purposes was increased.

Tax Limitation Measures

Five charter counties (Anne Arundel, Montgomery, Prince George's, Talbot, and Wicomico) have amended their charters to limit property tax rates or revenues. In Anne Arundel County, the total annual increase in property tax revenues is limited to the lesser of 4.5 percent or the increase in the consumer price index. In Montgomery County, the growth in property tax revenues is limited to the increase in the consumer price index; however, this limitation does not apply to new construction. In addition, the limitation can be overridden by an affirmative vote of seven of the nine county council members. In Prince George's County, the general property tax rate is capped at $0.96 per $100 of assessed value. Special taxing districts, such as the Maryland-National Capital Park and Planning Commission, are not included under the tax cap. In Talbot and Wicomico counties, the total annual increase in property tax revenues is limited to the lesser of 2 percent or the increase in the consumer price index.

County Salary Actions

An analysis of local government salary actions for county employees and teachers provides continued indication that most of Maryland jurisdictions are providing salary enhancements during uncertain economic times. In fiscal 2004, 13 counties and 21 local boards of education granted cost-of-living adjustments to their employees. In contrast, for the second consecutive year State employees received no additional cost-of-living raises, no merit increases, and no bonuses in fiscal 2004. **Exhibit 3** shows salary enhancements for county employees and teachers.

Exhibit 2

Local Tax Rates – Fiscal 2003 and 2004

County	Real Property FY 03	Real Property FY 04	Income CY 03	Income CY 04	Recordation FY 03	Recordation FY 04	Transfer FY 03	Transfer FY 04	Admissions & Amusement FY 03	Admissions & Amusement FY 04	Hotel/Motel FY 03	Hotel/Motel FY 04
Allegany	$0.984	$1.000	2.93%	2.93%	$2.20	$3.00	0.2%	0.2%	7.5%	7.5%	5.0%	5.0%
Anne Arundel	$0.950	$0.955	2.56%	2.56%	$3.50	$3.50	1.0%	1.0%	10.0%	10.0%	7.0%	7.0%
Baltimore City	$2.328	$2.328	3.05%	3.05%	$2.75	$2.75	1.5%	1.5%	10.0%	10.0%	7.5%	7.5%
Baltimore	$1.115	$1.115	2.83%	2.83%	$2.50	$2.50	1.5%	1.5%	10.0%	10.0%	8.0%	8.0%
Calvert	$0.892	$0.892	2.60%	2.80%	$5.00	$5.00	0.0%	0.0%	1.0%	10.0%	0.0%	5.0%
Caroline	$0.952	$0.952	2.63%	2.63%	$3.30	$5.00	0.5%	0.5%	0.0%	0.0%	0.0%	0.0%
Carroll	$1.048	$1.048	2.85%	3.05%	$3.50	$5.00	0.0%	0.0%	10.0%	10.0%	0.0%	0.0%
Cecil	$0.980	$0.980	2.80%	2.80%	$3.30	$3.30	$10	$10	6.0%	6.0%	5.0%	5.0%
Charles	$1.016	$1.016	2.90%	2.90%	$5.00	$5.00	0.0%	0.0%	10.0%	10.0%	5.0%	5.0%
Dorchester	$0.880	$0.930	2.62%	2.62%	$3.30	$5.00	1.0%	0.75%	0.5%	4.0%	5.0%	5.0%
Frederick	$1.000	$1.000	2.96%	2.96%	$5.00	$5.00	0.0%	0.0%	5.0%	5.0%	0.0%	0.0%
Garrett	$1.036	$1.036	2.65%	2.65%	$3.50	$3.50	1.0%	1.0%	4.5%	4.5%	4.0%	4.0%
Harford	$1.092	$1.092	3.06%	3.06%	$3.30	$3.30	1.0%	1.0%	5.0%	5.0%	0.0%	0.0%
Howard	$1.170	$1.170	2.45%	3.20%	$2.50	$2.50	1.0%	1.0%	7.5%	7.5%	5.0%	5.0%
Kent	$1.012	$1.012	2.58%	2.58%	$3.30	$3.30	0.5%	0.5%	4.5%	4.5%	3.0%	3.0%
Montgomery	$1.019	$1.019	2.95%	3.20%	$3.45	$3.45	1.0%	1.0%	7.0%	7.0%	7.0%	7.0%
Prince George's	$1.286	$1.319	3.10%	3.20%	$2.20	$2.20	1.4%	1.4%	10.0%	10.0%	5.0%	5.0%
Queen Anne's	$0.976	$0.976	2.85%	2.85%	$3.30	$3.30	0.5%	0.5%	5.0%	5.0%	3.0%	3.0%
St. Mary's	$0.908	$0.908	3.10%	3.10%	$4.00	$4.00	1.0%	1.0%	2.0%	2.0%	5.0%	5.0%
Somerset	$1.010	$1.010	3.15%	3.15%	$3.30	$3.30	0.0%	0.0%	4.0%	4.0%	3.0%	3.0%
Talbot	$0.553	$0.553	1.79%	2.25%	$3.30	$3.30	1.0%	1.0%	5.0%	5.0%	3.0%	3.0%
Washington	$0.948	$0.948	2.80%	2.80%	$3.80	$3.80	0.0%	0.5%	5.0%	5.0%	6.0%	6.0%
Wicomico	$1.047	$1.041	3.10%	3.10%	$2.30	$3.50	0.0%	0.0%	6.0%	6.0%	5.0%	5.0%
Worcester	$0.730	$0.730	1.25%	1.25%	$3.30	$3.30	0.5%	0.5%	3.0%	3.0%	4.0%	4.0%

Notes: Real property tax is per $100 of assessed value. Income tax is a percentage of taxable income. Recordation tax is per $500 of transaction.

Source: Department of Legislative Services Annual Tax Survey

Exhibit 3
Local Government Salary Actions in Fiscal 2004

County	County Government COLA	County Government Step	Board of Education COLA	Board of Education Step
Allegany	0.0%	No	2.0%	Yes
Anne Arundel [1]	0.0%	Yes	1.0%	Yes
Baltimore City [2]	Varies	Yes	1.9%	Yes
Baltimore	0.0%	Yes	0.0%	Yes
Calvert	3.0%	Yes	4.0%	Yes
Caroline	0.0%	No	3.0%	Yes
Carroll	3.0%	No	4.0%	Yes
Cecil	0.0%	Yes	4.0%	Yes
Charles	0.0%	No	2.0%	Yes
Dorchester	0.0%	No	6.0%	Yes
Frederick	2.0%	Yes	4.0%	Yes
Garrett	2.0%	Yes	4.0%	Yes
Harford	0.0%	No	1.0%	No
Howard	2.0%	Yes	4.0%	Yes
Kent	0.0%	No	0.0%	No
Montgomery [3]	Varies	Yes	4.0%	Yes
Prince George's [4]	Varies	Yes	N/A	Yes
Queen Anne's	0.0%	Yes	2.0%	No
St. Mary's	3.0%	Yes	2.0%	Yes
Somerset	2.5%	No	2.0%	Yes
Talbot [5]	0.0%	No	5.0%	Yes
Washington	2.0%	No	2.0%	Yes
Wicomico	1.0%	No	2.5%	Yes
Worcester	2.0%	Yes	2.0%	Yes
Number Granting	**13**	**13**	**21**	**21**

Source: Department of Legislative Services Annual Tax Rate and Salary Survey, November 2

Comments

[1] In Anne Arundel County, 15% of county employees received a cost-of-living adjustment (COLA) and more than 50% received a step increase. COLAs were set at 4% for Detention Center Officers, 3% for Detention Center Sergeants and Correctional Program Specialists, and 3% for County Labor and Maintenance Workers.

[2] In Baltimore City the COLA is set at 4% for CUB employees. Other rates vary.

[3] In Montgomery County the COLA is set at 3.5% for IAFF (fire fighters), 2% for Fire Management, 2% for FOP (police officers), 2% for Police Management, 3.75% for MCGEO, 2% for nonrepresented county employees, 4% for public school teachers, and 3% for public school administrators.

[4] In Prince George's County the COLA is set at 1.5% for non-union employees. COLAS for union employees vary. 3% for AFSCME, 2% for DSA (sheriffs'), 2% for PCEA (police officers), and 2% for corrections employees. The COLA for public school teachers is still being negotiated and is not available (N/A) at this time.

[5] In Talbot County, county employees except law enforcement and corrections will receive a 2% adjustment that will be issued in one check and will not be considered part of the employees' base pay. Law enforcement and corrections staff will receive a step increase.

Local Government

2004 Legislative Agenda – Maryland Municipal League

The Maryland Municipal League has selected three initiatives as its legislative priorities for the 2004 session: (1) protecting State assistance; (2) supporting legislation to extend the Heritage Structure Tax Credit Program; and (3) supporting legislation to clarify municipal zoning authority.

Protecting State Assistance

With an anticipated State budgetary shortfall in excess of $700 million for fiscal 2005, the Maryland Municipal League (MML) will direct its resources to offset anticipated pressures to achieve a balanced budget by reducing State aid to local governments. Also, MML will attempt to recoup some of the State aid that was reduced through various program cuts during the 2003 legislative session.

Heritage Structure Tax Credit Program

The Heritage Structure Tax Credit Program, administered by the Maryland Historical Trust in the Department of Housing and Community Development, was established in 1996. Since its inception, the program has undergone extensive changes through legislative initiatives. In its current form, the program provides Maryland income tax credits equal to 20 percent of qualified rehabilitation expenditures for the rehabilitation of a certified heritage structure.

Legislation adopted during the 2002 legislative session provided a two-year sunset for the Heritage Structure Tax Credit Program, terminating the program in June 2004 unless the General Assembly passes legislation to extend the program. MML values this program for its importance in preserving historical properties in incorporated cities and towns.

Municipal Zoning Authority

In 2002, the Maryland Court of Appeals issued a ruling in *Mayor and Council of Rockville et al. v. Rylyns Enterprises, Inc.* holding that the City of Rockville's initial zoning of annexed property was improper where the zoning of the property was granted subject to conditions set forth in the annexation agreement. The conditions prohibited certain uses of the property otherwise permitted as of right or by special exception in the zone assigned. Under the circumstances involved in the annexation by the City of Rockville, the zoning was held to be both impermissible conditional and contract zoning.

The court's decision effectively retains Montgomery County's zoning designation on the newly annexed parcel of land until the city revisits the issue and properly rezones the property. Further, MML contends that the ruling has implications for the ability of municipalities to enter into traditional annexation agreements where limitations on the use of properties to be annexed are typically included.

MML will propose legislation to amend Article 66B and Article 23A of the Annotated Code of Maryland to clarify that (1) existing zoning authority to impose certain conditions on the zoning of land includes the right to limit the uses that may be made of the land; and (2) as part of an annexation, a municipality may contract to specify a particular zoning classification upon annexation of a parcel, including limiting uses that might be allowed under the agreed upon zoning classification.

For further information contact: Georgeanne A. Carter Phone: (410) 946/(301) 970-5350

Local Government

2004 Legislative Agenda – Maryland Association of Counties

The Maryland Association of Counties (MACo) has identified four initiatives for its legislative agenda for the 2004 session: (1) protecting State assistance; (2) supporting legislation that will reverse the effect of a recent Court of Appeals decision regarding the collection of the admissions and amusement tax; (3) support legislation to amend the Maryland Public Information Act; and (4) establishing connectivity and interoperability of public safety communications systems.

Protecting State Assistance

With State aid to local government accounting for 26 percent of total State expenditures and the annual rate of growth in State aid reaching 11 percent, curtailing the growth in State aid may be one option to balance the State's anticipated budgetary shortfall in fiscal 2005. According to MACo, county budgets also are being challenged with many jurisdictions raising taxes and fees to provide current services. As a budget reconciliation strategy, MACo maintains that State reductions in statutorily mandated distributions to local governments is poor public policy, in large part because these reductions are simply an unfair shift of burden. If State reductions in statutorily mandated distributions to local governments are unavoidable, MACo will seek to ensure that the reductions are not structural or permanent and do not necessitate any diversion of county-generated revenues.

Refinement of the Admissions and Amusement Tax

A recent Court of Appeals decision (*Comptroller of the Treasury v. Clyde's of Chevy Chase, Inc. et al., Docket No. 11, September Term, 2002, Filed March 14, 2003)* overturned decades of collection practice of the admissions and amusement tax by the Comptroller of the Treasury. Traditionally, restaurants that provide refreshments "in connection with entertainment" have assessed the admissions and amusement tax under Section 4-101(b)(1)(v) of the Tax – General Article on the receipts from the refreshments sold while there was entertainment provided. In the *Clyde's* case, this practice was denied. The court found that, since the statute is ambiguous in regard to the nexus between refreshment sales and entertainment, a direct financial nexus must exist in order for the tax to be imposed. The court held that this tax could not be imposed on the restaurant's receipts while entertainment was provided, because the restaurant did not charge patrons to enter the facility, did not increase the price of refreshments during the entertainment, and did not require a minimum purchase for a patron to be present during the entertainment. MACo's position is that this ruling jeopardizes millions in local revenue and opens the door to multi-year appeals from taxpayers. MACo proposes legislation to reestablish the practice of taxing revenues when there is entertainment, whether the sales appear as gate receipts or as increased sales of refreshments.

Maryland Public Information Act and Discoverable Documents

As a general rule, Maryland's Access to Public Records Act (Title 10, Subtitle 6, Part III of the State Government Article), often referred to as the Maryland Public Information Act (MPIA), provides for broad access to public records unless a required denial or permissive denial is triggered. For example, a custodian is allowed to deny access to public documents and information that would ordinarily be subject to the judicial rules of pre-trial discovery. However, a recent Court of Appeals case *(John E. Hammen v. Baltimore County Police Department et al., 373 Md. 440, Filed March 14, 2003)* found that this protection only applies to judicial processes, not administrative or quasi-judicial processes. MACo maintains that this new ruling makes governments vulnerable to MPIA disclosure requests that attempt to circumvent the discovery process in workers' compensation, termination disputes, or other employee-related procedures. MACo will seek to introduce legislation to amend MPIA to ensure the discovery exception is applied uniformly to judicial and other similar proceedings.

Connectivity and Interoperability of Public Safety Communications Systems

State and local public safety agencies seek to employ communications systems that effectively coordinate their efforts, both on an ongoing basis and during critical incidents. In many cases however, these communications systems are dated and not cross-compatible among agencies and jurisdictions. MACo urges the State to partner with local jurisdictions implementing a system replacement or upgrade, so as to combine efforts to upgrade the State coverage in the same region and reduce costs to all parties. Through coordinated replacements, MACo maintains that the State/local partnerships will eventually yield a "backbone" sufficient to play host to a fully interoperable system of public safety communications, thus benefiting all agencies and the public they serve. Moreover, MACo urges the State to establish public safety interoperability as a priority for its homeland security distributions from the federal government.

Elections

Election Administration

Maryland's plan to upgrade and standardize its voting systems and election procedures continues despite concerns about the reliability and security of the recently acquired direct recording electronic (DRE) voting system.

Uniform Voting System

Maryland Follows National Trend to Reform Voting System

After the poor performance of punch card ballots and "butterfly" ballots during the 2000 presidential election, many states began to review their election procedures and equipment. This has led to a nationwide effort to upgrade outdated voting equipment and election procedures. Chapter 564, Acts of 2001 requires the Maryland State Board of Elections (SBE) to select a uniform statewide voting system for polling places and absentee ballots. By 2006, all jurisdictions in Maryland will be required to use the uniform voting system. SBE has begun implementation of a multiphase plan to comply with Chapter 564 and install a uniform direct recording electronic (DRE) voting system in all counties of the State. This plan is discussed in more detail below.

Help America Vote Act of 2002

In addition to the individual efforts of the states, the federal Help America Vote Act of 2002 (H.R. 3295) (HAVA or "the Act") established uniform election standards for every state and required that states meet these standards. SBE is merging the HAVA requirements into its multi-phase plan.

HAVA encompasses three separate titles. Titles I and II of the Act contain provisions that authorize funding to the states to assist in compliance with the Act. Approximately $3.6 billion in state aid is authorized for federal fiscal 2003, 2004, and 2005. Title I of the Act authorizes payments of up to $325 million for improvements to the administration of elections (Section 101 of the Act) and $325 million for replacement of punch card or lever voting machines (Section 102 of the Act).

Title II of the Act provides that states are eligible for annual "requirements payments" in return for compliance with certain conditions described by the Act. The Act authorizes a total of $3 billion to be distributed to states over federal fiscal 2003 through 2005. Specifically, $1.4 billion is authorized in fiscal 2003; $1 billion in fiscal 2004; and $600 million in fiscal 2005. Generally, requirements payments would be used to comply with Title III of the Act, or for certain other approved activities to improve the administration of elections. To date, the State has received about $7.3 million in Title I and Title II aid.

Title III of the Act outlines requirements governing disabled access to each polling place; criteria for determining what constitutes a legal vote in a state; a centralized, electronic, statewide voter registration database; provisional ballots; language options for non-English speaking voters; and maintenance of a polling place error rate below the threshold established by the Federal Election Commission.

There is currently a bill before the 108th Congress (H.R. 2239) that would amend HAVA to require a voter-verified permanent record or hardcopy of a person's vote under the Title III requirements and make various minor changes. The bill was referred to the House Committee on House Administration on May 22, 2003. The appropriations bill to implement HAVA is also currently being debated.

State's Implementation Plan – Phase I

After evaluating the various voting system vendors, SBE chose Diebold Election Systems, Inc. (DESI) AccuVote-Touch Screen (TS) electronic voting machines for polling place voting and Diebold AccuVote Optical Scan machines for absentee voting. DESI is a wholly-owned subsidiary of Diebold, Inc.

To test the Diebold machines, SBE entered into a contract with DESI to lease its DRE voting system for the four counties in the State that were still using mechanical lever machines (Allegany, Dorchester, and Prince George's) or punch card ballots (Montgomery). The voting systems in these counties would have been decertified under State law after July 2002.

The Diebold machines were first used in the four jurisdictions during the 2002 statewide primary elections. Montgomery County reported some difficulty and delays in reporting election results by individual polling places, but SBE officials noted that most of the problems arose from inexperienced poll workers and the lack of phone communication in polling places to facilitate data transmission via modem. In contrast, Prince George's County had comparably fewer difficulties as most of its polling places were able to transmit election results via modem.

State's Implementation Plan – Phase II

Based on the performance of the Diebold machines in the four counties, SBE signed a modification to the contract with DESI on July 19, 2003. Under the modification, DESI would provide its AccuVote-TS and AccuVote Optical Scan machines for the 2004 elections in 19 counties (all jurisdictions except Baltimore City) for up to $55.6 million. Baltimore City would implement the system for the 2006 elections. This modification was Phase II of the voting system implementation plan.

The Rubin Report

Phase II implementation was called into question by a report released by Aviel D. Rubin and several other researchers from Johns Hopkins University and Rice University. The report, entitled *Analysis of an Electronic Voting System* (the Rubin report), was released on July 23, 2003, and is available online at www.avirubin.com/vote. In the report, the researchers acknowledge that they are only analyzing the software code that DESI used and did not have access to either the DRE voting machines or State security protocols.

The report concluded that the DESI software was vulnerable to hackers, multiple voting, vote-switching, and interception and manipulation of election results. The Rubin report was extensively covered by the media and raised serious questions in the minds of many about the security and accuracy of the electronic voting machines.

The SAIC Report

In response to the Rubin report, Governor Robert L. Ehrlich ordered an independent review of the Diebold voting system by the Science Application International Corporation (SAIC). Diebold promised to take whatever corrective actions the SAIC report deemed necessary. SAIC looked at the software and hardware used in the AccuVote-TS system, as well as security controls that the SBE used in conjunction with the equipment.

The SAIC report, entitled *Risk Assessment Report, Diebold AccuVote-TS Voting System and Processes*, was released on September 2, 2003, and is available online at www.dbm.maryland.gov/SBE. The Department of Budget and Management (DBM) has redacted certain portions of the SAIC report that deal with confidential State security procedures.

The SAIC report found that

> "[w]hile many of the statements made by Mr. Rubin were technically correct, it is clear that Mr. Rubin did not have a complete understanding of the State of Maryland's implementation of the AccuVote-TS voting system and the election process controls or environment. It must be noted that Mr. Rubin states this fact several times in his report and he further identifies the assumptions that he used to reach his conclusions. The State of Maryland procedural controls and general voting environment reduce or eliminate many of the vulnerabilities identified in the Rubin report. However, these controls, while sufficient to help mitigate the weaknesses identified in the July 23 report, do not, in many cases meet the standard of best practice or the State of Maryland Security Policy."

Appendix B of the SAIC report addresses point-by-point the security issues raised in the Rubin report.

Several members of the General Assembly have requested that the Department of Legislative Services conduct a comprehensive review of the SAIC report and electronic voting issues in general. That review is due January 12, 2004.

State Response – Voting System Security Action Plan

Based on the findings of the SAIC report, DBM and SBE have decided to move forward with Phase II of the implementation plan. Diebold has modified its software based on the recommendations of the report, including the removal of an embedded passcode in the source code, implementation of a passcode utility program that allows a dynamic assignment of security keys, and incorporation of encryption into the electronic transmission of election results.

To address the procedural and administration issues raised by the SAIC report, SBE has created a three-phase action plan to improve its security and operational procedures for elections. It can be found online at www.elections.state.md.us. The following section outlines the steps in the action plan and its status. This information is from the action plan as revised on October 24, 2003.

Phase I of the action plan deals with improving cyber security and computer protocols of the SBE's systems as well as reviewing and testing the Diebold source code. All steps in Phase I are completed except for the performance of a risk assessment when computer system changes are made to ensure that the changes do not negate existing security controls. That is expected to be completed by November 17, 2003.

The main actions under Phase II of the action plan involve developing and implementing a security awareness training program, hiring a Chief Information Systems Security Officer, awarding a contract for personnel to assist in developing an Information System Security Plan (ISSP) for all SBE information technology systems, and developing a formal, documented process to detect unauthorized transaction attempts by authorized or unauthorized users. The implementation of Phase II is expected to be completed by January 31, 2004.

Phase III of the action plan requires implementation of an audit process for validating that local boards of elections are in compliance with the ISSP and the validation of existing procedures for 100 percent verification of electronic transmissions by the local boards of elections. Phase III is expected to be completed by March 3, 2004. The finalized ISSP is expected to be fully implemented by SBE by March 31, 2004.

Voter Registration

Since 1998, SBE has been working on development of an automated centralized voter registration database that allows SBE to interface with the 24 local election boards and other voter registration reporting agencies in the State in order to ensure that SBE maintains a regularly updated registry. Currently, 19 local jurisdictions are operating on the local area network interface (LAN) with the SBE. Each local election board provides a "mirror image" of its voter registry on the LAN, enabling the SBE to conduct regular duplicate registration checks. The five jurisdictions that currently are not using the LAN are Baltimore City and Baltimore, Harford, Prince George's, and Montgomery counties. Various State agencies also report voter registration information to the SBE via a wide area network.

HAVA requires that states maintain a centralized voter list that is used as an "official" registration list for elections. This list must be centrally maintained, cover all counties in a state, and be updated at regular intervals. Also, each registered voter on the list must have some kind of "unique identifier." Since only 19 jurisdictions are currently interfacing with SBE, the State does not meet the requirement that the list cover all counties in the State. In addition, the State's current voter registration system does not meet the update or unique identifier requirements of HAVA. In order to meet HAVA requirements, SBE has formed a workgroup which has worked in coordination with the local election boards to draft requirements for a new HAVA compliant voter registration system. These requirements have been made available to voter registration system vendors, and SBE has indicated that several have expressed interest.

In mid-spring of 2003, a subsection of the workgroup conducted a market analysis of most voter registration system vendors and checked to see if any of their existing products would be HAVA compliant. The market analysis revealed that none of the vendors' current products would meet its requirements. SBE hopes to hire a project manager for the voter registration database project by early December 2003. Request for Proposals (RFP) development planning will begin in early December and SBE hopes to release the RFP in early 2004.

For further information contact: Leslie Knapp Phone: (410) 946/(301) 970-5350